ARIZONA LAW REVIEW

SYMPOSIUM ON TRUST PLANNING

FALL 1959

VOLUME 1 NUMBER 2

Pages 175 to 338

Published by

THE COLLEGE OF LAW OF THE UNIVERSITY OF ARIZONA

ARIZONA LAW REVIEW

VOLUME I
1959

Published by
The College of Law of
The University of Arizona

Printed in

Tucson, Arizona, U.S.A.

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VOLUME 1 | FALL 1959 | NUMBER 2

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ARIZONA LAW REVIEW, published by the College of Law of the University of Arizona twice a year—Spring and Fall. SUBSCRIPTION PRICE, $3.00 per annum. Single copies $2.00.

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Symposium on Trust Planning

Foreword

The amazing population and industrial growth of Arizona within the past fifteen years has brought into focus those problems which inevitably arise in a complex urban society. One set of such problems has to do with property—the inheritance of property, the establishment of trusts, and the nature of estate and gift taxes. Various members of the State Bar of Arizona have for some time felt that a re-examination of the law of Wills, Probate, Trust, and Taxation was highly desirable. In fact, the Real Property, Probate, and Trust Law Section of the State Bar has only recently appointed a subcommittee to study the effect of our Perpetuities statutes upon pension and profit sharing trusts.

In recognition of this interest the College of Law and the Continuing Legal Education Committee of the State Bar proposed a one-day Institute upon the subject of Estate and Trust Planning. In laying plans for the Institute the Continuing Legal Education Committee of the Pima County Bar, an informal group of representative members of the Maricopa County Bar, as well as representatives of the trust companies, were all very helpful. Agreement was reached that there should be three main addresses in which would be discussed (1) the drafting of trusts (inter vivos and testamentary) and the problems therein confronting Arizona lawyers; (2) the nature of the Rule Against Perpetuities in Arizona and any recommendations that the speaker might have in regard to suggested legislative changes; and (3) the problems confronting Arizona lawyers in planning an estate which involves community property life insurance.

Each of the three main topics was to be presented by a nationally recognized authority in the field. In addition to these speakers it was decided to ask certain Arizona lawyers to discuss and comment on

the analysis made by the three main speakers. A further decision was made to hold the Institute first in Phoenix, and to repeat it the next day at Tucson.

Professor William J. Bowe of the University of Colorado delivered the first address, on draftsmanship problems of testamentary and inter vivos trusts. Mr. Bowe is both a teacher and practitioner, and is in great demand as a lecturer throughout the United States. Only recently he published his treatise, *Estate Planning and Taxation,* which has been very well-received.

Professor Richard R. Powell of Columbia University, in the second address, presented his analysis of the Perpetuities statutes of Arizona. Since Professor Powell had been Reporter for the American Law Institute's *Restatement of Property* and is also a practitioner, he was well qualified for undertaking an analysis of this portion of our Arizona property law. He presented his subject with clarity and thoroughness, and made thoughtful recommendations whereby our law might be improved.

Professor Samuel D. Thurman of Stanford University spoke upon the difficult subject of community property life insurance and federal taxation. This illuminating address was likewise focused upon the problems of Arizona lawyers in accordance with the purpose of the Institute. Some of our lawyers had read Professor Thurman's scholarly analysis of community property life insurance law in the March 1957 issue of the *Stanford Law Review,* and so looked forward with more than usual anticipation to his appearance on our program.

Governor Paul Fannin addressed the noon luncheon at the Phoenix meeting. His subject, The Potential Industrial Development in Arizona, was forcefully presented and emphasized for those present the timeliness of the Institute program. The Honorable Lewis W. Douglas prepared an address for the Tucson luncheon on the subject, The Future and Potentialities of Southern Arizona. When circumstances prevented Mr. Douglas from attending the luncheon, his prepared speech was presented by Mr. Robert Howe of the Southern Arizona Bank and Trust Company. The Committee was particularly pleased that these two distinguished Arizonans, Governor Fannin and Mr. Douglas, consented to make their fine contributions to the Institute program.

The interest in the Institute was such that we received numerous demands for publication of the proceedings in our Law Review. Since a tape recording had been made of most of the speeches and comments, the work of preparing the proceedings for publication was begun. With the exception of Professor Powell's address, the speeches and comments appearing herein were taken from the recorder and edited before being sent to the respective speaker for further editing. Unfortunately,

because of certain mechanical difficulties it was not possible to get some of the speakers' comments.

In editing the speeches an effort was made to preserve as far as possible the conversational nature of the address. It was believed that such a presentation in the Law Review would better preserve the clarity of the speaker's thought and contribute to the reader's ease of understanding the material. No effort was made to make a complete interpolation of footnotes, although footnotes were occasionally inserted.

Many individuals and organizations assisted in planning the Institute and in providing financial aid both for the Institute program and for the publication of the proceedings. Thanks are particularly due to the Maricopa County Bar Association, the Pima County Bar Association, the State Bar of Arizona, and the principal Trust Departments in Arizona. The Continuing Legal Education Committee of the State Bar and Mr. Donald Phillips, Secretary of the State Bar, greatly assisted in preparing and planning the Institute program.

We wish also specially to thank Governor Fannin, Mr. Douglas, and the attorneys whose appearance on the program materially added to the success of the Institute.

James J. Lenoir, Chairman
Institute on Trust Planning

Draftsmanship Problems of Testamentary and Inter Vivos Trusts

WILLIAM J. BOWE*

In 1926 the Federal Estate Tax on an estate of $200,000 was $1,500. Today it is $32,700. A half-million dollar estate in 1926 paid a tax of $12,500 and today it is $145,000. Income tax-wise, we have the the same contrast. The married man with two children and an income of $10,000, paid a tax of $40 a year in 1926. Today it is a little closer to $40 a week. This heavy impact of taxation has revolutionized the way in which wills are drawn so that the 1926 will looks as outmoded today as the 1926 Ford does. What I plan to do this morning is to review with you some of the changes that have come about in the drafting of wills because of the tremendous impact of federal taxation. I want to talk about a few cases from my personal experience, as well as a number of the decided cases.

Precatory Trusts

The first thing I want to talk about is the old precatory trust. A precatory trust, as you know from law school days, is not really a trust at all, but is a bequest in which the testator imposes a moral rather than a legal obligation. It was thought of as a happy device if you wanted to give some member of the family the whip hand over another member and not harass him with the possibility of being called into court for an accounting. In one case there were two sisters who inherited the father's department store. Over the years the department store interest grew in value so that each one had about $500,000. One of these sisters never married. The other married and had a son who in turn married and had three children. He was a worthless fellow who drank all the time, so when the married sister died she left a will in which she bequeathed everything to her sister, "with the confident expectation, but without

* See Contributors' Section, p. 284, for biographical data.

imposing any legal obligation, that she will take care of my son and his family." So the spinster received this $500,000, stock of the company, put it away, never thought of it as being hers, and took care of the family over a period of 12 to 15 years. The only time she realized this money was hers was in March or April when she got around to filling out her income tax returns. Then the income from this stock was added to her income and about half of it went to the federal government. As she got to be in her early seventies, she began to worry about the estate taxes on this additional bequest. So, when the youngest child became 21, she made an equal division into five parts—to the son, his wife, and to each of the three children. She paid a gift tax of about $100,000. Then she began to worry that she would not live long enough to get beyond the three year statutory protection against gifts in contemplation of death. As it turned out, she died before the three years were up, so the issue was then raised whether this was a transfer in contemplation of death. The point I am making is that to the unmarried sister the moral obligation was as real as the legal obligation. But if the will had said, "to my sister to be used by her for the support of my son and his family," then none of the income would have been taxed to her; since it was used for these five persons it would have been spread among five tax entities. When she got ready to make her distribution she would have avoided any gift tax because she would have held it as a trustee; she would not have been making a gift, and hence would not have had to be concerned with a gift in contemplation of death. But the mere fact that it was a precatory trust imposed tax burdens that were well in excess of $200,000, with substantially no greater powers on her part than if an informal trust had been created.

Another Supreme Court case that is quite similar is the *Mississippi Valley Trust Co.* case.[1] There a testator in his will left a million dollars to his sons and in one paragraph said, "I make no bequest to charity. I discussed my charitable desires with my sons and I am perfectly confident they will carry out my wishes." Then the residue went into a trust for the sons. The sons, again because they felt the moral obligation as keenly as the legal obligation, gave a million dollars to the University of St. Louis. The executors attempted to deduct this in the Federal estate tax return, but the deduction was disallowed on the grounds that the sons were the absolute owners of the property, and hence, this was not a charitable bequest. The effect of that was to cost the estate something better than $400,000, which might well have been completely avoided if the will had said, "I give $1,000,000 to my sons to be used as gifts to such charities as they may determine." They would not have felt under any greater compulsion because of the legal obligation to make the distribution than

[1] Mississippi Valley Trust Co. v. Commissioner, 72 F.2d 197 (8th Cir. 1934).

they did with simply the moral obligation. So precatory trusts can be extremely expensive things.

Compensation Bequests

With respect to compensation bequests, the statute says that a bequest shall be exempt from income tax. But this means a gratuitous bequest—a gift bequest. In a case in Louisiana, a bachelor died with remote next of kin, and left no will. Three of his business associates, who had been with him for twenty years, brought an action alleging that he had made a contract with them that he would leave the business to them if they would continue in his employ during his life. They set up a beautiful cause of action, but when it was suggested to them that if they in fact recovered, the recovery would constitute taxable income, they lost their enthusiasm. The business was valued at about $600,000. Each of the three would have gotten $200,000 in bricks and mortar and would have had a tax of $150,000 to pay on the income, with no money with which to pay it. So they were perfectly happy to withdraw the suit if they were given some assurance of continued employment. This illustrates a perfectly ruinous kind of bequest, with no ability to spread the cost over the years.

In the Tax Court case of *McDonald v. Commissioner*,[2] the decedent left his entire estate to Miss McDonald, who was his nurse, "In recognition of her long and faithful service to me." Fortunately, he added "Miss McDonald has comforted me in my sorrow and bereavements." The Commissioner assessed a tax on the entire estate as ordinary income to Miss McDonald, taking the position it was additional compensation to her. Miss McDonald, however, casting all modesty aside, testified that she had lived with the deceased for eight years before his death. The Tax Court fortunately found that the relationship had far more family than commercial flavor about it, and so they held in favor of the taxpayer. But don't we often in wills unduly stress the compensatory aspects of these bequests to household servants, and employees and business associates, when we set forth that the bequest is because of the long and faithful service? That, in effect, is simply raising a red flag that it may be taxable compensation. There is no benefit to the estate, even though it may be found to be compensation, since it is all done without a binding legal obligation, and therefore not deductible for estate taxes. But it may well constitute income to the recipient if the predominating motive is the

[2] 2 T.C. 840 (1943).

desire to compensate, rather than the desire to make a gratuitous gift at death arising out of love and affection. I've been talking about cases with a whole lot of money, I suppose the reason being that it's only the cases with a lot of money that get up into the upper courts, but the doctrine is equally applicable to smaller amounts.

Dollar Amount Bequests

Another pitfall is represented by the *Kenan*[3] case. Here, the decedent, a very wealthy man, left his entire estate in trust for his son for life, with a direction that the trustee distribute to his son, at age 40, five million dollars. The trustee satisfied this bequest with a million eight hundred thousand dollars worth of bonds, and three million two hundred thousand dollars worth of stocks. The three million two hundred thousand dollars of stock had a cost basis to the executor of a million two hundred thousand dollars. It was held that the estate had incurred a long term capital gain of two million dollars on the distribution. In other words, the executor had satisfied a three million two hundred thousand dollar obligation with assets that had a cost to him of one million two hundred thousand dollars. And wherever you satisfy an obligation with a low-cost-basis asset, you have capital gain. If you have some stock that cost you $100 and you deliver it in satisfaction of a $300 dental bill or rent bill or any other obligation, you have a $200 capital gain. That is exactly what happened in the *Kenan* case. On the other hand, if this testator had provided in the will that the income was to be paid to the son until age 40, at which time one-third of the principal would be distributed to him, or one-half of the principal, then there would have been no capital gain, because then there would be no dollar amount due. So it is particularly important in bequests of any size, if the distribution is to be delayed for any substantial period, to use language which makes the gift in terms of a fractional share, rather than a stated dollar amount.

Income Bequests

The next item I want to talk about relates to income in respect of decedent items. There are a whole lot of items in an estate which get no cost basis and which are taxable as income in full to the beneficiaries. I suppose the best example is the insurance agent who dies with ten years of renewal commissions coming in. These commissions are taxed as part of his estate at their present value. They don't get a basis. Each dollar collected on these renewals, since it's compensation income, will

[3] Kenan v. Commissioner, 114 F.2d 217 (2d Cir. 1940).

be taxed to the executor if he receives it and doesn't distribute it, or to the beneficiary if the cause of action is distributed to the beneficiary. When lawyers, doctors, and accountants die, a very large portion of their estates will consist of unrealized receivables, and these again are income in respect of decedent items. A good many business executives will have rights to receive deferred compensation that will continue after death. Up to 65, the executive may take a lesser salary, if the company agrees to continue him at $10,000 a year as long as he lives, and his wife thereafter at $5,000 a year. If he dies before age 65, the payments for the wife may go on for a longer period of time. Now those are again taxable as part of his estate, but get no new basis because they are classified as income in respect of the decedent.

Particularly, for a charitable bequest this type of income ought to be used. A Californian left the university out there $50,000. The executor attempted to satisfy this with the monies that were coming due to the estate from the decedent's company, but the court taxed the executor on this amount as income in respect of the decedent. They said that the will had made a *capital bequest* of $50,000. But if such provisions are worded differently, if instead of giving to charity $25,000, a capital bequest, you would give the charity "one-fifth of my renewal commissions," in an insurance case, or "the first $25,000 out of my deferred compensation," then what the charity gets is taxable income, which doesn't concern it since it doesn't pay a tax, and the legatees get the capital which is free of income tax.

Now for a variation of that, suppose the decedent wants to give $25,000 to five separate charities, $5,000 to each. If he says "$5,000 to *A* charity, $5,000 to *B* charity, $5,000 to *C* charity, etc., the residue to my wife," the wife is going to have the taxable income, the charity is going to get the capital amount. If he sets up a testamentary trust which provides that "the first $25,000 of income is to go to the following five charities," then the widow will receive no income for a period of a year or two years, whatever time may be required; the charities will receive the income, but will pay no tax on it. He might well make a compensating bequest of $25,000 to the wife earlier in the will to offset the loss of income. The wife will then receive the $25,000 and will keep the whole amount instead of half of it. The income goes to the charity.

Residuary Bequests

Now, so much for general bequests. When we come to the residuary bequests, I suppose mostly you'll be dealing with community property, so let's talk about that half of the community over which the husband

has the power of disposition. He may, of course, leave all that to the wife. Let's assume an estate of $200,000. If he leaves his entire interest in the community, amounting to $100,000 for his half, to his wife outright, he'll pay a federal tax of $4,800. But the wife will now have $200,000, and on her death she will pay a tax of $32,700. If, instead of giving the wife his interest in the community outright, he gives it to her for life, then you pay the same tax at his death, but on the later death of the wife she will have an estate of only $100,000 and pay a tax of $4,800, a difference of better than $27,000 through giving her the life estate rather than the fee. Of course, he wants to give her the complete use of the money—she's the primary object of his benefit. So the problem of the draftsman is to what extent he can avoid the $27,000 of unnecessary taxes—more than 25% of the overall estate—as well as the additional costs of executor's fees and attorney's fees on her death. To what extent can we give the widow the benefits of this $100,000 without the burdens? To what extent can we approach absolute ownership and still keep the property within the concept of the life estate for purposes of death taxes?

Here, the federal law is, I think, extremely liberal in the powers of appointment section.[4] First, of course, you'd give the widow the income from this, his half of the community, which is normally what she would expect. Then, under the powers of appointment section she may be given an absolute power to withdraw 5%, or $5,000, of the corpus each year, a non-cumulative right. This means that if she fails to withdraw one year, the next year she can still withdraw only the $5,000, or 5%. It doesn't accumulate from year to year. Congress said in 1951, when they were revising the powers of appointment statute, that it was desirable to permit flexibility in smaller trusts and to permit small withdrawal privileges. They didn't think they were opening too wide a door when they permitted this $5,000 invasion privilege. Next, they defined a general power of appointment (which is the only power that attracts an estate tax) as not including a power of invasion measured by a substantial, objective standard relating to health, education, maintenance, or support. Consequently, in addition to giving the widow the income, and the $5,000 withdrawal privilege, she (not the trustee) may be given the privilege of invading the corpus to whatever extent necessary to maintain her accustomed standard of living. And that, I think, is a fairly well accepted case law standard. If we get into a depression, if she has extraordinary medical expenses, if there are real needs in order for her to maintain her accustomed standard of living, then she may not merely ask the trustee, but demand from him, whatever amounts in excess of the income and in excess of the $5,000 may be needed. That gives her the maximum

[4] INT. REV. CODE OF 1954, § 2041.

kind of protection. She wouldn't invade it without needing it. If she wants a European trip, she can take the $5,000 out, but she wouldn't go to much larger amounts unless she had some real need for them.

We can, of course, in addition, give the trustee the absolute power to pay out in his discretion so that he may, if she can persuade him, give her larger amounts without regard to a need. Then we can also give her a special power of appointment by deed to appoint the property to and among the children, and that tax free, any time during her life. If the daughter gets married and the mother wants to give her a house, she can direct the trustee to distribute $20,000 to the daughter in the exercise of this special power of appointment without attracting any gift tax. If the son wants to go into business and needs money to invest, she can direct the trustee to make a distribution to him, whatever amount of capital she desires. The only limitation is that she can't pull out more for herself than this $5,000, or 5%, of the corpus unless it's needed to maintain her standard of living. And lastly, we can give her a special power of appointment by will which will enable her to appoint the property to anybody she likes, so that she's got the complete, absolute, testamentary disposition over it provided she's willing to forego the doubtful pleasure of being able to give it to her creditors. That's the only limitation imposed on her. Now, hasn't she got something very close to practical ownership, without paying this $27,000 extra in federal taxes—for she has the income, the right to withdraw the $5,000 at her whim and pleasure, the right to demand more (an equitably enforceable right) if she needs it, the power of appointment by which she can make distributions to the children during her life (free of any gift tax), and the complete testamentary disposition of it at her death?

Trust as Income Saving Device

The trust is not only a device for the saving of estate taxes; it's a tremendously useful device for the reduction of income taxes. The trust is a second tax pocketbook. It is a tax entity and it pays an income tax on some of the trust income. Even a trust that directs all the income to be paid to the life beneficiaries will nevertheless serve to reduce taxes because a portion of income will nevertheless be taxed to the trust. The reason is this: What is income in the trust sense or the local law sense is totally different from what is income in the tax sense. I suppose the most obvious illustration of that is in the capital gain area. If we give this lady the $100,000 outright, and she has a $10,000 or $12,000 long-term capital gain, she puts 50% in her ordinary income and has it taxed at whatever her top bracket happens to be. If it's a trust, with the same assets and the same capital gain incurred, the capital gain is not

distributable, since under the trust law it is not income. It is therefore taxed to the trust and the trust takes half of the gain into its ordinary income. But it begins at a 20% bracket; whereas if the widow had taken it, it would be taxed at whatever her top bracket happened to be.

Now in addition to that, we can create a number of tax pocketbooks through the device of creating separate trusts. This is an extremely useful device and something which Congress is now trying to deal with, but is finding it extremely difficult to reach the tax-avoiding opportunities in this area. If I have three children I may, either by will or by an inter vivos transaction, deliver $100,000 to a trustee and tell him to hold it, invest it and reinvest it, collect the income, and pay one-third of the income to each of my three children; and as each child gets to age 40, distribute to him one-third of the corpus. There I have a single trust. However, with some different phraseology—for practical purposes it's very largely phraseology—I may say to the trustee, "Here's $100,000. First, divide it into three separate shares, and hold each share as a separate and distinct trust, share *A* for child *A*, share *B* for child *B*, and share *C* for child *C*." Then I have three separate trusts. Moreover, these three trusts may own undivided interests in the same asset. It's well settled that the trustee might buy 100 shares of General Motors and allocate one-third of it to each of the trusts.[5] If he subsequently sells the asset with a $12,000 capital gain, we have, because of the three trusts, three gains, each in the amount of $4,000. We carry over half of each gain. What we do is tax the capital gains three times at a third, rather than once in the full amount, as would be necessary if we had one trust with the children having separate shares. What you have to do is to make it clear that the trustee is to hold each share as a separate and distinct trust and then to carry out in the instrument the phraseology that clearly shows that you have three trusts rather than one trust in which the children share. Most of the litigation in this area has arisen because the draftsman wasn't quite sure what he was doing and sometimes it looked as though there were separate trusts, and sometimes as though it was a single trust with each beneficiary having a partial interest.

I learned this morning that in Arizona you have the problem of a Rule Against Perpetuities that is different from the common law rule, in that you are limited to two lives. I do not suppose that it would be advantageous, wholly aside from this, to go beyond this limit. If you had three children, you would have to create three separate trusts if you wanted the widow to have the income for life, and then each child to have income for his life. New York had that problem until a year ago.

In addition to the separate trusts we may in some limited number of cases authorize the trustee to accumulate income. The income that is

[5] United States Trust Co. v. Commissioner, 296 U.S. 481 (1936).

distributable is taxable to the beneficiary, while the income that is accumulated is taxed to the trust. In a large estate where there is more income than needed, it is a tax waste to distribute all to the widow. If you say the trustee may in his discretion pay out or accumulate, then to the extent the trustee decided to accumulate the income, the tax is on him (the trust) and what he pays out is taxed to the wife. He may well take taxes into consideration, as well as the needs of the widow, in determining what the distribution shall be. The only limitations on that since 1954 are the throwback rule which taxes to the beneficiary any amount of accumulated income up to a five-year period, so that the trustee can't accumulate this year, as he used to do, and then pay out in January of next year as a capital interest. But the accumulation rule is full of exceptions that still make it an extremely handy device.[6] It doesn't apply wherever the amount of distribution of prior accumulated income does not exceed $2,000. It doesn't apply to accumulations during a minority, so that you can accumulate until the child is 21 and then pay it all out, having had it taxed to the trustee. It doesn't apply on the termination of a trust, and it doesn't apply to accumulations that are paid out on an objective standard where there are some emergency needs—I think these are the statutory words. But in most cases people won't be interested in the trustee doing too much accumulating because most people need income annually and most people hate to spend the principal. However, they may have two trusts and let one of them accumulate all the income and have it taxed to the trust, and then have the trustee pay out of the other trust not only the income but a corresponding amount of capital. And you can show how you build up one trust as you diminish the other.

Now, let's assume that we have a client who doesn't want to dip into capital and doesn't want to use this accumulation device. He can sprinkle the income under what's called the "spray" or "sprinkle" trust. Let's assume that we have a trust, with the half of the community going to the wife, and on her death to the son. The son is 23 (let's get him over 21 to avoid a minority problem) and he's going to medical school. The instrument may authorize the trustee to pay the income to mother or to son; or, if it's a trust for the son, it may authorize the trustee to pay the income "to my son, John, or to any one or more of John's issue in such amounts or proportions as the trustee may determine." There the trustee has the power to distribute the income among a group in any amounts that seem to him to be wise. And this, incidentally, is not a tax gimmick. This is something the English lawyers devised two or three hundred years ago, partly to avoid the fact that in England you can't have a spendthrift trust, and they needed a way of keeping the property away from creditors. But if we have John, now, the father, and if he's to get $4,000 of trust

[6] 1 BOWE, ESTATE PLANNING AND TAXATION § 4.19 (1957).

income under the instrument and he's a 50% bracket taxpayer, he gives $2,000 to Uncle Sam and he has $2,000 left for son John's medical education this year. The trustee may pay the income in his discretion either to John or to any one or more of John's issue. If the trustee, with an eye to the ultimate use and the tax burden, distributes the $4,000 to the son, then the son is the taxable beneficiary, and since he has a $600 exemption and a $400 standard deduction, assuming no other income at all, then he has $3,000 that's subject to tax. The tax is about $600 which means that there's $3,400 from the same gross income available for his medical expenses during the year, instead of $2,000.

A useful provision that I suppose ought to be in all wills is a kind of indirect accumulation clause. It is a power in the trustee to invest in life insurance on the lives of any of the beneficiaries. It's not a direction to do it, but an authorization to buy such life insurance. To the extent that the trust buys insurance on the lives of the beneficiaries, the income is taxable to the trust because it is accumulated income. It is income that is non-distributable. Now, if John is a 50% taxpayer and he gets $4,000 of trust income, he gives Uncle Sam $2,000 and he has $2,000 left for premiums on insurance. If the trust buys the insurance, the trust pays the tax on $4,000 at the 20% and 22% level. The trust will have something like $3,300, so the trust can buy something better than one and a half times as much insurance. Instead of a $40,000 policy on John's life, the trustee can buy $60,000. The trustee would own the policy and name itself beneficiary, so that there are no tax consequences to John. If, however, the trustee has $60,000 on the life of John, then John doesn't need any insurance because the trustee can use this money to serve normal insurance objectives on John's death. Once the trustee collects the proceeds and has the liquid cash, he can be authorized to buy assets in John's estate, or he can lend the money, or you can have a distribution clause that will distribute something on John's death. There's no problem about getting the liquid funds over to the executor to serve normal insurance needs. And in addition to that, the trustee owns the policy and it is not a part of John's estate, so you not only have one-and-a-half times as much insurance, but the whole face amount escapes any death tax. John would not only have bought a lesser amount had the income been distributed to him, but then the federal government would also have taken another crack at it at his death. Generally, wherever there are any insurance needs, it will be far more desirable to have the insurance purchased through the trust.

Marital Deduction Bequests

Now let's talk a little about the marital deduction problems. I'm sure you have some of them since a lot of Eastern people come out here to live

and they bring with them a good bit of separate property. I suppose that to a considerable extent they like to keep the property separate, so you, like the lawyers in common law states, have to familiarize yourselves with marital deduction formula clauses. There is no answer other than the use of a formula clause. Let's assume that some Easterner comes out here with $200,000, of which $120,000 is in stocks in his own name. $50,000 is the face amount of his life insurance, and some $30,000 is in jointly owned property in Illinois where he paid the whole purchase price. Now, the insurance is part of his estate and, of course, so are the stocks and the whole of the jointly owned property. They are all separate property. Out here he may or he may not acquire other property which becomes community. If he leaves all of this property to his wife outright, he is going to get the marital deduction, but you are going to have a tremendous tax on her death. If he puts it all in trust, and in the same way disposes of his half of the community interest, then you are going to lose the marital deduction. On this assumption you will be paying a tax on his death of $32,000 instead of a tax of $4,800.

Now if we were sure the assets were going to stay just the way they are, then his will ought to give $20,000 to his wife outright and the remainder in trust, because the $20,000 outright, plus the insurance, plus the jointly owned property, would give you the exact amount of the marital deduction. But the trouble is that assets don't remain static—some life insurance agent may come to him and suggest that he ought to have the insurance paid in installments to his wife over the years, with the secondary beneficiary, the daughter, thereby disqualifying the proceeds for the deduction. They might sell the property in Illinois and he might take all that in his own name, or he might split it up so that she's got half, and he's got half, or he might give it all to her. All kinds of things could happen to make the assets held differently at death than they are at the time you're drawing the will.

The only solution that has been found is the marital deduction formula clause by which I give that fractional share of my estate that is equivalent to the maximum allowable marital deduction. It may be put exactly that way or, as I have it in the will here, "my executor shall set aside one half of my adjusted gross estate, etc." This is then defined as the gross estate less death and administration expenses, but less the value of all assets that pass outside the will and that qualify for the marital deduction. If you want to look at the clause, it's on page 2 of the model will. The first paragraph on that page sets forth how the executor shall determine the amount of the marital deduction. If, in the case put, the husband still had exactly the same assets at death—first get his gross

estate—we'll say he had $200,000 community and the $200,000 separate property, his gross estate then would be $300,000; but you exclude from the gross estate, to get the adjusted gross, the community property plus the debts of administration expenses. Now if we exclude the $100,000 community, and then if we take off $20,000 for debts and administration expenses, that would leave us an adjusted gross of $180,000, and a maximum marital deduction of $90,000. So the executor would immediately set aside $90,000 as a tentative figure and from that he subtracts the value of all interests in other property which passes or has passed to the wife under the will, or otherwise, if they qualify for the marital deduction; so that he would subtract from the $90,000 the $50,000 insurance and the $30,000 jointly owned property. Thus, under this paragraph the wife would be entitled to $10,000. If, however, after the will was drawn he changed his insurance in such a way that it no longer qualified for the marital deduction, then under this paragraph we'd set aside the $90,000 and subtract the $30,000 jointly owned property. Then under this paragraph we'd get $60,000 to which the wife would be entitled. If he had also changed the jointly owned property so that it no longer qualified, then under this paragraph $90,000 would pass.

This is a self-adjusting paragraph that always assures you the maximum marital deduction without getting too much of it and without regard to how the testator shifts his assets after the drawing of the will, the only exception being that you can't control and can't get the exact maximum where the assets passing outside the will exceed more than a half of the tax estate. There's just nothing you can do if 80% of the assets passed outside of the will other than to keep after him every year to see that he didn't disqualify too much of that, or qualify too much of this. But so long as 50% of the tax estate passes under the will, this clause will adjust it so that you get the exact amount of the marital deduction—not too much, not too little. And it's just as costly taxwise to give more to the wife outright or to give more to the wife in such a way as to qualify it for the marital deduction, as it is to give her too little.

You get the marital deduction if the wife gets the bequest outright, or if she gets it for life with a general power of appointment; and that may either be through a legal life estate or through a trust. If the bequest is in trust for the wife, the regulations require that the wife be entitled to all of the income for her life and that the trust must be designed to be income-producing. This is an unfortunate pitfall because generally when we're drafting instruments—I suppose ever since the depression—we customarily put in a provision that the trustee may invest in unproductive property or may hold cash uninvested. We give him broad powers

both as to buying stocks and with respect to buying other assets that are not designed to produce the normal amount of income. There we vary from what would be permissable under the trust law. The way I've set this up here, we have, third, the marital deduction trust, and fourth, the residuary trust; and then we come over to page 12 where the first clause is the normal investment powers of the trustee under which he may hold cash uninvested in whole or in part, hold marketable securities of little or no yield—powers that make a whole lot of investment sense today. However, the presence of this clause is enough to disqualify the marital deduction bequest unless you add to your marital deduction bequest what I have on page 3 in the second full paragraph: "notwithstanding anything to the contrary contained in this my will, I direct that in establishing this trust there shall not be allocated to the trust any property or the proceeds of any property that does not qualify for the marital deduction and the trustees of this trust shall not retain beyond a reasonable time any property which may be or become unproductive, nor shall they invest in unproductive property." So what you do in the general powers is give him this broad power; but as to the marital trust he may not hold cash unproductive, nor may he invest in property of little or no yield.

The marital deduction cases, many of them, have been extremely strict, and I think the legal life estate cases are also causing a lot of trouble. First of all, I suppose we have to realize that most of these revenue agents aren't lawyers at all, and if we don't want the matter to go to the courts, we must make the will painfully clear to them. We had a case when I was in Tennessee—a nontax case—where the widow was given the land for her life with the power to sell and consume. The widow gave the property to a nephew, and on her death the executor moved to set it aside on the ground that she had no power to make a gift of the property. She had the right to sell it and consume it, but not to make a gift of it, and the Tennessee court upset the deed. Now such a bequest would not qualify for the marital deduction because she doesn't, under that interpretation of the language, have a general power of appointment. And most of our traditional clauses in legal life estates with powers to consume would not give a general power of appointment because we say "to my wife for life, with the power to consume for her health and welfare or for her needs." All that type of thing where the power isn't absolute, *i.e.,* to do anything she likes with it including the power to give it away, will cause a loss of the marital deduction. So it seems to me the only safe way to draft these clauses is to say "to my wife for life and then to such person or persons including her estate or her creditors as she may by last will and testament appoint." You spell it out in the words of the statute and then the agent will know what it is—he had to read those words to get his job. After that, you can put down

anything you like—she may consume it for her health and welfare and happiness, she may sell it. You may say anything you like as long as you've got in there the general power by will.

Revocable Trusts

I want now to mention the revocable trust because it seems to me you might have some use for that. It is an excellent way, I think, to keep the separate property separate. You get a lot of people who come out here with separate property and they want to keep it that way. If they let it get mixed up with the community at all, you have the presumption that it's all community. The revocable trust is a wonderful device as a will substitute. If property is put in a revocable trust, you've got it separated. The great advantage of the revocable trust is the continuity it gives you; you avoid all the delays of administration and you avoid a good many administration expenses. I think we lawyers are beginning to realize that in the administration of an estate we ought to charge about as much for a revocable trust as we do for the assets that come through the hands of the executor, because they cause about as much trouble and take as much time. However, a revocable trust has a tremendous continuity. Suppose that the income is to go to the grantor for his life and upon his death to his widow, or upon his death to his child. If he dies on the 15th of March, he got his check on the first of that month, and the child gets her check on the first of the next month. You don't have any interruption. Or suppose that the trustee was about to execute a long-term lease on some property and the negotiations were going on during the month of March. If the grantor died on the 25th, the trustee could sign the lease on the 26th. But if he has the assets in his own name, then all these negotiations are up in smoke and everybody's got to wait till you get an executor appointed and then you start the whole process all over again.

The revocable trust is an excellent device to avoid will contests. Although the gift may still be set aside for fraud or undue influence, there is very much less chance of this. As you know, a will contest is a kind of happy hunting ground. All of the heirs have been waiting around for a week to see what the will says, and they've rushed down to court, and they've built up their hopes, and now they're disappointed. If there has been a revocable trust in operation for years, as a practical matter they just don't get too upset over it. Another reason I wanted to mention the revocable trust is that you may qualify it for the marital deduction through the same type of formula clause we use in wills.

Inter Vivos Trusts

Now just a few words on the draftmanship of inter vivos intruments.

Gifts during life will obviously reduce the estate tax, particularly if the settlor lives for a minimum of three years so that we get behind the protection of the contemplation of death statute. He must not reserve a life estate in the property and that means he may not reserve what's called a secondary life estate; that is, he may not have the income "payable to my wife for her life and if I survive back to me until my death." He may not have the income payable to his wife and then to the children, with the proviso that it may be paid to him if he needs it, because that's a secondary life estate. He's got to divorce himself completely from the property. He may not keep any substantial possibility of reversion; he may not say "to my wife for life, or to my wife in fee, but if she predecease me, to come back to me." There are pitfalls here.

In the *Spiegel* case[7] the grantor said, "income to my three children and if any be dead, to their issue," with final distribution at his death. He failed to say what would happen if all the children and grandchildren died before he did, and that was a conceivable possibility. He might have chartered a plane to bring them all up to Maine for his birthday in the summer, and the plane might have blown up. Then all the beneficiaries would be gone and by operation of law the property would have come back to him. He died without any of this happening. All the children, all the grandchildren were alive. It was a million dollar trust, and the whole million was included in his estate because of this remote possibility of reverter. Actuarially, his chances of ever getting it back were regarded as worth $70, but the Supreme Court said that's enough to require inclusion. Now the present federal act[8] says that there shall be no inclusion in the estate if the possibility of reverter is not worth at least 5%; that is, there must, as of the date of the grantor's death, be at least one chance in twenty of the reversion taking effect. But you can't always count on people dying in the right order. You may set up a trust where his chances are only one in forty, but some grandchild dies, or a son dies, and they may jump up and get over the 5%. It's a little better, unless there's a substantial reason for keeping the remote possibility in him, to vest it in the estate of the last surviving beneficiary; for if he outlives his beneficiaries, the property will probably come back to him by operation of law under the intestacy statutes. At any rate, he won't have retained anything.

Another requirement is that he may not have any power of disposition, or power of revocation or alteration or amendment. In the *Lober* case[9]—I think the most extreme one on this point—the father set up the trust to pay the income to his son. The income was to accumulate until

[7] Spiegel's Estate v. Commissioner, 335 U.S. 701 (1949).
[8] Int. Rev. Code of 1954, § 2037.
[9] Lober v. United States, 346 U.S. 335 (1953).

the son was 21, then the son was to receive the income, with the corpus to be paid to him at 30. But the old man, as trustee, had the wise discretionary power of being able to pay out capital in his discretion. The court held that was enough to require inclusion of the fund in the old man's estate because they said he had a power to terminate prematurely. The court's argument has real substance to it. The father didn't really give the property to the child in possession or enjoyment when he set up the trust—what he did was say, "I'm going to decide at what point to give it to you; maybe I'll give it to you at 18, maybe at 21, maybe at 25;" but he held back that substantial power.

There was another case just decided last month, the *State Street Trust Company* case,[10] which would seem to make it almost impossible, if the case is sound, for a grantor to be a trustee or to be one of twenty trustees (since the statute in every section says, where the grantor has the power alone or in conjunction with another). In the *State Street* case the grantor was one of several trustees. They had a power to allocate receipts between income and principal, and they had a power to control investments. These were powers that up to then had not been regarded as enough to require inclusion in the estate of the settlor. But the treasury attacked it on the ground that the grantor had a right to change the beneficiaries. They said that if he got mad at the income beneficiary, he might have invested in unproductive property. If he wanted to pay to the income beneficiary at the expense of the remainderman, he might have invested in property that was speculative but produced a large amount of income. Up to then it was thought enough if you excluded the grantor from any decisions with respect to dispositive provisions. But now you've got to restrict him, if the *State Street* case is sound, from any control over the administrative provisions. And that in effect means that you just can't make him trustee.

[10] State Street Trust Co. v. United States, 263 F.2d 635 (1st Cir. 1959).

DISCUSSION

Comment by George Read Carlock*

Mr. Bowe has given us what seemed to me very fine words of wisdom regarding the preparation of wills and trusts and the tax questions involved. There is a provision in his model will, which has been distributed to you, which I believe is worthy of some attention as having important and substantial tax aspects, as well as non-tax aspects, of concern both to the fiduciaries who are struggling with the administration of an estate and to the beneficiaries. I invite your attention to item FIRST and Item SECOND in Mr. Bowe's model form, dealing with "The dispositions of tangible personal property and disposition of the residence of the testator and his wife." Probably all of us have seen wills—I'm sure all of the trust officers here have worried with wills—in which all of the testator's assets were bequeathed to the trustee, with directions that the trustee invest the property and do so-and-so with the income. The trustee then finds itself as the owner of all, or with a community interest in a house, automobile, a lawn mower, furniture, pots and pans, electric iron—things which are difficult to administer, and difficult to make any sense out of from an investment viewpoint.

Obviously, if the question had been thought of, the testator would have wanted his wife to be entitled to use these assets without the payment of any rent for them and to treat them as her own. So what is the trustee going to do? What are the trustee's duties to the residual beneficiaries of the trust? If the widow is permitted to use assets without compensation, without charge, in the absence of specific authority in the trustee to permit that, then what about the will, or the will and trust? Obviously then, there is some merit in leaving residence and personal effects outright to the widow or to other beneficiaries, rather than leaving them to the trustee to worry with. We then have the question of how that is to be accomplished. With respect to personal property, Mr. Bowe's model will leaves to the widow "tangible personal property except property being used by any business in which I may be interested." I believe that the executor's problem in segregating assets, whatever the description, is going to be a difficult one whether this language or any other language is used, when the problem is to separate personal type assets from business type assets. The problem is of particular concern in cases where the testator operated a business as a sole proprietorship. In that event we might

* Member of the Phoenix Bar.

want to consider the wisdom of expanding the directions to the executor and trustee so as to give them authority to continue to operate the business at the risk of the estate or the trust, and not at the risk of the executor or trustee individually.

Finally, if we're going to have so much difficulty in segregating the kind of assets that can pass under this item FIRST of the model will from the kind of assets that are to pass to the trustee, why don't we leave it up to the statute which in Arizona would permit the setting aside to the widow of the probate homestead and the personal property which is exempt from execution, and which might come at least very near to accomplishing the objective of the testator? Or is there a sound tax reason for making a specific bequest of this personal property rather than leaving it to be distributed by the executor because of the operation of law? Mr. Bowe, I believe all of us would appreciate it if you would expand on your reasons for this item FIRST, with some attention to the tax reasons for doing it this way, rather than leaving it to the operation of law.

MR. BOWE: It would seem to me that prior to 1954 it was extremely sensible to put everything into the residuary trust with a power in the trustee to make distributions of capital to the widow, and then the trustee could turn over all this property to her use (your statute would have achieved the same result). But the taxation of estates changed very radically in 1954, as most of you know. Prior to 1954 a distribution from the executor to the residuary legatee could be labeled either as a distribution of income or of principal when you sent the widow a check for $5,000 in six or eight months after the death of the decedent. You could tell her that this was a principal payment and then it was capital to her and income to the estate. But that opened the door to a tremendous amount of avoidance; people would keep estates open twenty years in order to have a separate tax entity, and they were always making capital distributions. To get away from that, Congress in 1954 said that the income to the estate shall be taxed to the estate, if not distributed; income shall be taxed to the beneficiary, if distributed; and then they said that every distribution from the estate shall be income to the distributee to the extent of the estate's income. There are two exceptions to that—a bequest of specific property, and a general bequest of a sum of money payable in not more than three installments.

This 1954 rule can have an unfortunate effect. Suppose that the decedent dies, let's say in June, and we close the estate tax year as of December 31st. During the remainder of the year—the short tax year of the estate—we collect some seven or eight thousands of dollars in dividends or income in respect of a decedent item. No distributions

are made to the widow at all, except that the automobile that was registered in his name now has been registered in her name and all the household furnishings which he owned are now left in the house and she has assumed complete dominion and control over them. In effect she has received a distribution of an automobile, and the distribution of a lot of household effects from the estate. She is the residuary legatee; and so, when the executor in his return fills out the income received, eight thousand dollars, and comes to the line, "distributions," he has got to put down four, or five, or six thousand dollars, whatever the market value of those things is, and she is subject to the income tax on those receipts. It's a very unfortunate rule. You may have an estate that's received twelve, fifteen, or twenty thousand dollars of income. Toward the end of the year you make a partial capital distribution. You distribute 5,000 shares of X stock. That is income. Receipt of that capital item under the current statute is income to the widow to the extent of the estate's income. Now you can avoid that completely where you have a specific bequest of these items, because a specific bequest comes within the exception to the rule. There is a present proposal before the Mills Committee which would, in effect, go back to the pre-1954 practice in spite of the avoidance opportunities, because of the tremendous administrative difficulties that this thing has caused.

Comment by Arthur M. Davis*

One item in this draft will that particularly took my attention was the provision whereby the powers and duties, with respect to the estate, that are normally given to the trustee are also specifically and clearly given to the executor because there are many times when the discretionary powers that everybody is thinking about the trustee exercising may need to be exercised before you have distribution.

Two other matters occurred to me which I wonder if Mr. Bowe could comment briefly on—the first is the confusion that results from the inaccurate choice of terms, such as using *heir* and then in the same context later on using *issue*, and not making a clear distinction through the use of any particular rules that are helpful to the average practitioner; and secondly, the situation that we're finding more common where a substantial part of the assets of a person consists of life insurance and they desire to establish a life insurance trust. What about the desirability or nondesirability of the will providing just a pour over clause that whatever assets belong to the testator at his death be delivered to the trustee under the life insurance trust, and administered as a part of that, rather than setting up a separate trust?

* Member of the Phoenix Bar.

MR. BOWE: I don't know whether the practice is getting at all prevalent here, but in a number of states there has been legislation or proposed legislation that would enable you to make the life insurance payable to the testamentary trustee. Have you had any of that? You can have, as I have suggested, a revocable life insurance trust which is simply a typical revocable trust. Then, as regards the insurance policy, the beneficiary is changed to the trustee. The settlor retains the ownership of the policy, the right to the cash value, he keeps the physical possession of the policy, he can go borrow on it. On his death, though, the proceeds are paid to the trustee under the terms of the revocable trust. You have an immediate trust because the trustee, as of the day of the execution of the trust and the change of beneficiary, becomes the owner of the unmatured claim against the insurance company. That hasn't presented any problems.

But rather than create the separate trust, a number of lawyers have, with the approval of a number of insurance companies, made the designated beneficiary the trustee under the terms of "my will." Now that has caused a lot of technical difficulty because a trust requires a present conveyance; you've got to create it right now. But Wisconsin has a statute which permits this way of doing it; we have one before our legislature in Colorado; Pennsylvania recently passed such a law; and there's some split in the case law. It seems to me it may be a dangerous practice where you haven't either a statute or the case law to support you, unless, under conflict of laws, about which I know very little, the fact that you have a Northwestern policy and a statute in Wisconsin, or a Penn Mutual policy and a statute in Pennsylvania, is going to make this sort of thing good. Now the alternative to that and the safe way of doing it is to create the revocable insurance trust. Then under the will, a short one-page will, give all the rest, residue, and remainder to the trustee under the trust created on such-and-such a date.

Again, you may run into uncertainties in case law. Some courts have said that this violates the rule against incorporation by reference. That, to some extent, can be avoided if you refer to the existing trust and you are very careful not to make any amendments without also changing the will, or if you create an irrevocable insurance trust. There may be some wisdom in the irrevocable insurance trust. But I think there's some uncertainty in that whole area that makes it difficult unless you have a well-established law in your jurisdiction. I don't want to take any business away from the local trust companies, but if I had the client here and that's what he wanted to do, and that looked like the sensible thing to do, I would create the revocable trust in Illinois or Pennsylvania or some place where I had case law that

made it good. One of the advantages of the revocable trust is that it gives you a choice of state law. You may create a revocable trust in New York now and get away from your limitations on the Rule Against Perpetuities and you might also get away from these problems. Or the safest thing, I think, is to get legislation validating the pour over, though they're probably good without it, since the whole trend of opinion in the varying states has been toward sustaining them, and all the leading authorities do. Professor Scott had an excellent article in *Trusts and Estates* on pour overs.[1]

Comment by C. A. Carson, III*

There's a peculiar little question that has presented itself to quite a segment of our corporate fiduciaries and bar. Assume a marital deduction trust consisting of a half of the adjusted gross estate as finally determined for federal estate tax purposes with the usual reduction substantially in the form of the clause in Mr. Bowe's form under item THIRD, with the last sentence, a common one, reading as follows: "All values shall be those finally determined for federal estate tax purposes." This marital deduction portion, if you wish to call it that, is to be in the marital deduction trust. Further assume that on the date which is used for valuation for federal estate tax purposes the adjusted gross estate is a million dollars, and that on the date you're ready to distribute the estate it is worth a million-and-a-half dollars. The question is: Under the federal estate tax law and, perhaps more importantly, under the provisions of this clause of the will, what can the executors allot or contribute to the marital deduction trust? Must it be half of the adjusted gross estate as finally determined for federal estate tax purposes, using those values; or can it be $750,000, which is one-half of the value of the estate on the date of distribution?

Mr. Bowe: I think the allotment clearly must be both on the basis of $750,000 and in properties that had a value of $500,000 at the date of death. I think the trouble is that we tend to think of the tax law as being something that's completely remote from our ordinary law. The executor is a fiduciary. If I may vary your facts a little bit, perhaps the problem can be put more clearly. Suppose the estate consisted of $500,000 of General Motors and $500,000 of Chrysler stock. The General Motors went up to $1,200,000 and the Chrysler went down to $300,000. Now since the executor is to use the values

[1] A. W. Scott, *Pouring Over*, 97 Trusts & Estates 189 (1958).

* Member of the Phoenix Bar.

at the date of death, he could literally fulfill the clause here by taking the Chrysler, the $300,000, and giving it to the widow and saying, "Now you've got property that was worth $500,000 at the date of death." Or if he happened to be squiring the widow around town, he could take the General Motors and give her $1,200,000 and say, "Now you've got property worth $500,000 at the date of death, the tax value which I'm supposed to give to you." But it's inconceivable that the local probate judge would say that the executor had that power. He's a fiduciary; he's got to deal fairly with everybody. And the only way to deal fairly with everybody is to look at the values as of the date of distribution, as well as the values as of the date of death.

I think there's one New Jersey case—these problems are just getting into case law—there was a New Jersey case and, I think, one surrogate opinion in New York. The problem was whether the fiduciary obligation of the executor to deal fairly with each of these people meant that he had to give them equivalency of value. I don't think there's any possibility of any court holding that. If a court should hold it, then you wouldn't get the marital deduction; that was the original argument that was urged on this problem. Also, if the state law was such that the executor could make the distributions arbitrarily as of the date of death, then he has the equivalent of the general power of appointment, or a special power of appointment, I should say. But I think that is not so. We've had the marital deduction with us now for better than ten years. These formula clauses haven't caused any of the trouble that people originally thought they would. The federal law doesn't change our probate law. I think we can rely on our state judges to insist on fairness to all of the residuary legatees.

Comment by Thomas B. Hargis, Jr.*

Thank you, Mr. Bowe. I know that we all appreciate not only your excellent discussion, but also the valuable model instruments which you have given us. Just how valuable they will be can best be illustrated by a few examples of the unexpected tax consequences that can result when such instruments are drafted without such a guide.

Let's assume that we are drafting the wills disposing of an estate consisting solely of community porperty valued at $200,000. In order to avoid the second tax, we have placed the husband's share of the property in trust with income to his wife for life. We have also provided that the wife has power to invade the corpus of the trust in an amount not to exceed $5,000 per year, and in such other amounts

* Member of the Tucson Bar.

as may be necessary for her health, education, maintenance, and support. Now, however, our client comes in and says he wants his wife to be happy after he is gone and wants her to have enough money from his share to make sure she is happy. Without further thought we add the words "and/or happiness" to our invasion clause so that now the trustee may pay to the wife such amounts as are necessary for her health, education, maintenance, support, and/or happiness. By such an addition we have changed the entire tax consequences. Even though some of the standards are objective, the Internal Revenue Service holds that such a provision is not limited by an objective standard and constitutes a general power of appointment. Therefore, the value of the trust established by the husband would be includible in the wife's estate on her death and the tax consequences would be the same as though the husband had left all his property to his wife in the first place. Thus, the addition of one word to the invasion clause of the husband's will has resulted in additional estate taxes of approximately $27,000. Another expensive word!

Now, let us look at the model will which Mr. Bowe has given us. You will note that in item THIRD the wife is given the general power to appoint the corpus by will. Let us suppose, however, that our client wants his wife to be able to give part of the corpus to the children during her lifetime if she so desires. We, therefore, give her a special power of appointment by deed whereby she can do so. Ordinarily, the exercise or release of a special power has no gift tax consequences. The exercise or release of a general power, however, is a taxable gift. It is the view of the Treasury Department that if the wife exercises her special power she releases her general power and would be subject to gift tax to the extent of the amount released. Thus, by adding an additional clause, one may have subjected the estate to additional taxes without accomplishing a great deal. Thanks to Mr. Bowe, we can now avoid such costly mistakes.

Before I close, I would like to ask Mr. Bowe if he would be so kind as to give us his opinion as to the relative advantages taxwise of the marital deduction formula clause as used in his model will and the fractional share type clause referred to in the notes?

MR. BOWE: A dollar amount bequest may result in capital gain to the executor. Thus if a general legacy of $50,000 is given to *A* and the executor satisfies this bequest with property that has a cost basis to him of $35,000, he will incur a tax on a $15,000 capital gain. A fixed amount marital deduction bequest may be subject to this objection. A fractional share bequest never incurs capital gain, since there is no dollar amount indebtedness. However, in the formula amount bequest in the

model will, it is not believed that any capital gain tax would be incurred because of increase in the value of the assets distributed to the wife, since her legacy is in terms of the values as finally determined for federal estate tax purposes. On the whole, the fractional share bequest may be preferable since it avoids the risk, however slight, that the deduction might be disallowed because of the possible power in the executor to give, at his option, assets that have either increased or decreased in value.

MODEL WILL, WITH EXPLANATORY COMMENTS, OF THE FATHER OF A CLOSELY KNIT FAMILY GROUP, DESIGNED TO MINIMIZE FAMILY ESTATE AND INCOME TAXES*

WILLIAM J. BOWE

LAST WILL AND TESTAMENT OF MARITAL DEDUCTION SPRINKLE, OF SPECIAL POWER, TAXHAVEN, A MARRIED PERSON OF SUBSTANTIAL MEANS

I, Marital Deduction Sprinkle, of Special Power, Taxhaven, being of sound and disposing mind and memory, do hereby make, publish and declare this to be my Last Will and Testament, hereby revoking all wills and codicils heretofore made by me.

FIRST
Tangible Personal Property

All of my interest in tangible personal property of every nature and wheresoever situated, except any such property being used by any business in which I may be interested, I give and bequeath to my wife, Mary, outright, if she survives me; if she fails to survive me, I give and bequeath said personal property to those of my children who are then living in equal shares determined by them or, if they fail to agree within six months after the appointment of my Executors, then in equal shares determined by my Executors.

Comment: The problem of the division of the mass of miscellaneous tangible personal property, i. e., household effects, jewelry, automobiles, etc. among children is always a difficult one. Detailed lists containing gifts of specific items are rarely satisfactory since exchanges and replacements of many items are frequent and the needs of particular beneficiaries may be totally different at the date of distribution than at the date of the will.

Generally fear of disharmony and recriminations as a result of alleged unequal divisions or sales at sacrifice prices is very much less common than testators anticipate. But assuming such probability,

* The Model Will first appeared in Volume 9, page 765, of the VANDERBILT LAW REVIEW. Mr. Bowe has made some slight changes in the Model Will to adapt it to the subject matter of his address to the Institute on Trust Planning. We wish to express our appreciation to the VANDERBILT LAW REVIEW for permission to publish this material.

no solution is likely to obviate it. Sometimes division is made by appraisal of these items and then permitting selections in an order predetermined by either lot, age, or sex. It is believed preferable to make the executor final arbiter, though this may at times put him in a difficult position.

SECOND
Residence

I give and devise to my wife, Mary, all my right, title and interest in whatever real property, together with the improvements thereon, that my wife and I are using as our residence or residences at the time of my death, absolutely and forever.

THIRD
Marital Deduction Trust

If my wife, Mary, survives me, I direct my Executors to set aside a portion of my estate equal in value to (a) one-half of the value of my adjusted gross estate (gross taxable estate less funeral and administration expenses and debts but before the deduction of estate and inheritance taxes) as finally determined for Federal estate tax purposes, less (b) the value of all interests in property, if any, which pass or have passed to my wife under other items of this my Will or otherwise than under this Will but only to the extent that such interests are for the purposes of the Federal estate tax law included in determining my gross taxable estate and allowed as a marital deduction. All values shall be those finally determined for Federal estate tax purposes.

I give, devise and bequeath the said portion of my estate to my Trustees, hereinafter named, IN TRUST NEVERTHELESS, to hold, manage, invest and reinvest, to collect the income and to pay over the income in equal quarterly installments to my wife, Mary, during her life. My Trustees shall also pay over to my said wife, Mary, such amount or amounts of principal as she may from time to time demand in writing delivered to the Trustees except that such principal payments shall not in any one year exceed the sum of $25,000. My Trustees may pay over to my said wife such additional amounts of principal as they may from time to time in their sole and absolute discretion determine. In the event my wife shall at any time become ill or if for any reason my Trustees shall consider her unable to manage her own affairs, they shall have power in their sole and absolute discretion, in lieu of making payments direct to her, to use, apply or expend for her benefit the entire income and whatever amount or amounts of principal they may determine.

Upon the death of my wife, my Trustees shall transfer, convey and pay over any remaining principal of this trust to or for the benefit of any person or persons or corporation or corporations or the estate of my wife, in such amounts and proportions and in such lawful interests and estates, whether absolute or in trust, as my wife may by specific reference to the power appoint by her Last Will and Testament. If this power of appointment is for any reason not validly exercised by my wife in whole or in part, then upon her death such portion or all of the principal of the trust or such interests or estates therein as shall not have been validly appointed by her shall fall into and become a part of the residuary trusts established by Item FOURTH of this my Will.

Notwithstanding anything to the contrary contained in this my Will I direct (a) that in establishing this trust for my wife there shall not be allocated to the trust any property or the proceeds of any property which would not qualify for the marital deduction allowable in determining the Federal estate tax on my estate and (b) that the Trustees of this trust shall not retain beyond a reasonable time any property which may be or become unproductive property nor shall they invest in unproductive property.

In the event of any uncertainty regarding the interpretation of the provisions of the trust established by this Item THIRD of this my Will, it is my intention that its provisions shall be interpreted in a manner which would permit the assets of this trust to qualify for the marital deduction authorized by the Internal Revenue Code, or now or hereafter amended.

My wife, Mary, may disclaim, in whole or in part, the devise and legacy given to the Trustees by this Item THIRD of this my Will, in which event so much of the said devise and legacy as may be disclaimed shall fall into and become a part of the residuary trusts established by Item FOURTH of this my Will.

In addition to any other method of disclaimer recognized by law my wife may disclaim this devise and legacy by an instrument in writing delivered to the Trustees declaring her intention to disclaim in whole or in some designated part.

Comment: This bequest qualifies for the marital deduction since the income is required to be paid to the wife at least annually and she is given a general power of appointment over the corpus.

It will always be difficult to estimate in advance the probable amount of the marital deduction and the percentage thereof that may be advantageously provided for by the terms of the will. The values of the estates of each of the spouses as of the uncertain dates

of their respective deaths must be estimated. Allowances must be made for expected changes. Possible inheritances must be considered. Only the roughest kind of an approximation is possible. To avoid this type of guesswork the deduction may be keyed to the will with a provision defining the gift to the spouse as 50% of the decedent's adjusted gross estate minus the value of any other property interests which are included in his gross estate and which pass or have passed to the other spouse in a form which qualifies them for the marital deduction. This would seem to be preferable to an attempted estimate wherever full use of the deduction may possibly be desirable.

An immediate reduction in taxes will often be preferred even though this results in a somewhat heavier tax burden upon the subsequent death of the other spouse. This is so because the survivor will have the use of the money resulting from the temporary postponement of the tax during the period of his life, and the substantial reduction in the cash immediately needed for taxes may eliminate any necessity for selling estate property at sacrifice prices since a longer period is available for an orderly liquidation of frozen assets.

It will generally be found advisable whenever doubts exist to provide for full use of the deduction with an accompanying provision authorizing the survivor to renounce the legacy in whole or in part. In the absence of such a provision there may be some question under state law as to the right to renounce partially. The Internal Revenue Code specifically provides that where a spouse renounces, the property is treated as passing from the decedent to the person who then becomes entitled to it. (INT. REV. CODE OF 1954, § 2056(d)). Thus a gift qualifying for the full marital deduction and authorizing partial renunciation enables the survivor to decide to what extent the deduction may profitably be availed of, and this decision has been postponed until most of the uncertainties upon which the earlier guess would have had to be predicated have been resolved.

Any gift of a fixed amount to the wife is so likely to be wide of the mark as to make gifts of lump sums highly unsatisfactory. Nor will a bequest of "one-half my estate absolutely to my wife and one-half in trust" achieve the objective since in very few cases will the estate passing under the will equal the tax estate. Jointly owned property, life insurance, interests in deferred compensation arrangements may form part of the tax estate but not of the probate estate. Indeed the largest portions of many estates pass outside the will. Assume that X has the following assets:

	Separate Property	One-half of Community Property
Cash in Bank		$ 5,000
Residence		20,000
Insurance, wife beneficiary	$60,000	
E Bonds, payable on death to his wife	20,000	
Business Interest		40,000
Stocks	80,000	15,000
	$160,000	$80,000

His tax estate will consist of $240,000. His probate estate will total $160,000 (his half of the community plus his stocks). The maximum allowable marital deduction, ignoring debts and administration expenses, will be $80,000. If his will leaves one-half of his non-community estate to his wife outright, she will receive $40,000; but as the $80,000 passing outside the will qualifies for the marital deduction, his will will have unnecessarily qualified $40,000. The effect of this will be to subject the $40,000 unnecessarily to tax on the wife's later death.

On the facts assumed nothing should have been left to the wife under the will in such a way as to qualify for the deduction. But the difficulty with so drafting the will is that assets do not remain static. Assume X cashes the bonds on maturity. He then invests the proceeds in securities in his own name. Further assume that because of the income tax saving involved (INT. REV. CODE OF 1954, § 101 (d)(1)(B)) he elects one of the installment options under his insurance as the method of payment to his wife, naming his daughter as secondary beneficiary. Now nothing outside the will qualifies and, if the will qualified nothing, the deduction would be wholly lost.

What is needed is a flexible clause keyed to the deduction such as provided in this Item. Under such a clause the maximum deduction, no more no less, will generally be obtained in spite of future changes in the way in which assets are held. This will become clear if the clause is studied with the fact situation above in mind. Under the clause, ignoring debts and administration expenses, there would be tentatively set aside $80,000 and from this would be subtracted the value of any assets passing to the widow which qualify for the deduction. This would include, in the supposed case, the bonds and the insurance, but only if, at the time of his death, these assets (1) form part of his tax estate, (2) pass to his wife, and (3) qualify for the deduction.

A word of warning about the indiscriminate use of these clauses may be appropriate. They have been criticized and they can cause real trouble in a limited class of cases. Assume a second wife who is not on speaking terms with the children of the first marriage. The husband's probate estate consists of $150,000. To placate the children who resented the second marriage he had given them $50,000 two years before his death. The Commissioner suggests this may have been in contemplation of death. He also suggests that the husband's business interest may be worth $50,000 more than the executor concedes. Under the clause suggested the widow is on the Commissioner's side. Her bequest under the will, if the gift is determined to be in contemplation of death, will be increased by $25,000. If the Commissioner's valuation of the business is finally sustained, her bequest will be further increased by another $25,000. But this is the unusual situation. In most cases family harmony exists and all can be counted on to assume a properly adverse position to the tax gatherer.

The best evidence of the practicality and desirability of these formula clauses has been the almost universal approval by trust officers and probate lawyers who have watched them in operation for the past ten years.

Many practitioners and corporate executors prefer a fractional share type clause such as the following:

> If my wife survives me, I give to my trustees hereinafter named and their successor or successors that fractional share of my residuary estate which will equal the maximum estate tax marital deduction (allowable in determining the Federal estate tax on my gross estate for Federal estate tax purposes) diminished by the value for Federal estate tax purposes of all other items in my said gross estate which qualify for said deduction and which pass or have passed to my wife under other provisions of this will or otherwise. In making the computations necessary to determine such fractional share, the final determinations in the Federal estate tax proceedings shall control. Such fractional share shall be held in a separate trust as follows:

FOURTH
Residuary Trusts

All the rest, residue, and remainder of my property of whatsoever kind and wheresoever situated I give, devise, and bequeath to my Trustees hereinafter named, IN TRUST NEVERTHELESS, to divide the same into equal shares as follows:

One equal share for each of my surviving children, and one equal share collectively for the living issue of each deceased child of mine.

Each such share shall be held, managed, invested, and reinvested, as a separate and distinct trust, and the net income of each such trust, in the sole and absolute discretion of my CORPORATE TRUSTEE and without its being required to observe any precept or rule of equality, may be:

(a) distributed in whole or in part to my wife, Mary; or

(b) distributed in whole or in part to that child of mine because of whom the trust was established; or

(c) distributed in whole or in part to that child's spouse; or

(d) distributed in whole or in part to any one or more of the descendants of that child; or

(e) distributed in whole or in part to any one or more of the beneficiaries of any of the other trusts established by this Item FOURTH of this my Will; or

(f) expended in whole or in part to acquire and pay premiums on life insurance contracts on the lives of any one or more of the beneficiaries of any of the trusts established by this Item FOURTH of this my Will; or

(g) accumulated in whole or in part and added to the principal of the trust.

In exercising its sole and absolute discretion over income my CORPORATE TRUSTEE shall consider but shall not be controlled by the fact that each separate trust is being established by me primarily for the benefit of a particular living child of mine and his family or the issue of a particular deceased child of mine.

During the lifetime of my wife, if there should arise any circumstances making it desirable, in the sole and absolute discretion of my CORPORATE TRUSTEE to distribute principal to my wife, my Trustees may pay over to her or apply for her benefit such amount or amounts of principal at such time or times as my CORPORATE TRUSTEE may determine. It is my desire, however, that prior to the distribution of any principal to my wife from any of the trusts established by this Item FOURTH of this my Will, the assets of the trust established under Item THIRD of this my Will shall first be exhausted.

At any time during the existence of the trust established by this Item FOURTH of this my Will my CORPORATE TRUSTEE may pay over to any one or more of the beneficiaries, other than my said wife, such amount or amounts of principal at such time or times as it may in its sole and absolute discretion determine. The power granted herein to my CORPORATE TRUSTEE shall include the power to pay over

the entire principal of all the trusts to any one or more of the beneficiaries.

In exercising its sole and absolute discretion over principal my CORPORATE TRUSTEE shall consider but shall not be controlled by the fact that each separate trust is being established primarily for the benefit of a particular child of mine and his family or the issue of a particular deceased child of mine.

Comment: This clause illustrates the technique of creating several separate trusts and using the accumulation and sprinkle devises:

(a) *Separate trusts.* The trust device offers many income tax saving possibilities. Thus where a trust is being created for several beneficiaries the careful draftsman will provide for a separate and distinct trust for each individual beneficiary. If, for example, there are five children to share in the fund, the property may be given to the trustee with instructions:

1. To pay one-fifth of the income to each child, or
2. To divide the property on receipt thereof into five equal parts and to hold one such part for each child as a separate and distinct trust and to pay each child the income from his part.

This latter arrangement does not create any administrative difficulties since each trust may own a one-fifth undivided interest in each item of property and the five funds may be administered as a unit. The advantage is that five separate tax entities have been set up. Assume the trustee buys Blackacre for $50,000 and some years later sells it for $80,000. As capital gains are normally taxed to the trustee, the trust or trusts have incurred a $30,000 long term capital gain. If there is a single trust and no other taxable income the trust would pay a tax of about $5,200. But if the gain is split five ways it is taxed at lower brackets and with five exemptions instead of one. The combined taxes would run about $3,200. Separate trusts are particularly important where accumulation powers are provided.

(b) *Discretionary Power to Accumulate Income.* In the past very considerable income tax savings were available through use of accumulation provisions. Where a beneficiary does not need all the income from the fund it is a tax waste to require that it be distributed to him. Prior to the 1954 Code under a discretionary accumulation trust, the income which the trustee decided to pay out was taxable to the beneficiary, the portion retained was taxable to the trust. Thus in years when the beneficiary was in high tax brackets income could be accumulated and later paid out as capital. The 1954 Code attempts to prevent this tax avoidance device by

the new five-year-throw-back rule. This rule is designed to impose the tax on a beneficiary who receives a delayed payment of accumulated income, as though it had actually been delivered to him in the years received by the trustee (limited to accumulations of the prior five years). There is thus no tax benefit in accumulating for two or three years and then distributing. But the exceptions to the throw-back rule leave open many of the tax saving plans formerly available. As Casner points out, for all practical purposes the old advantages are still available under the new Code. See Casner, *The Internal Revenue Code of* 1954: *Estate Planning,* 68 Harv. L. Rev. 433, 467 (1955).

The throw-back rule does not operate on:

1. Distributions on the final termination of a trust if made more than 9 years after the creation of the trust or after the last transfer of additional capital to it.

2. Emergency payments, even though they come from accumulations of the prior five year period.

3. Income accumulated while the beneficiary is a minor.

4. Distributions from prior accumulations of $2,000 or less.

This special $2,000 exclusion emphasizes the desirability of separate trusts since if there are five trusts, instead of one, as in the example above, $10,000 of prior accumulations may be paid out without incurring the adverse effects of the rule.

(c) *Discretionary Power to Sprinkle Income.* It may be that the entire income from the trust will be needed by the primary beneficiary for the support of his family but paying it all to the high-bracket income tax member can be wasteful. Thus if the Primary Beneficiary has two sons in college it would obviously be far cheaper to have the income distributed and taxed to the sons than to their father who would have to add it to his other income. This may be accomplished through a sprinkle provision similar to the above or a clause authorizing the trustee with respect to the income of the trust "to pay the income to or apply the income for the benefit of any one or more of a group consisting of my son John and the issue of John living from time to time in such amount or amounts as the trustee may in his sole uncontrolled discretion determine." The trustee may then distribute the income with an eye to the tax burdens.

Note the decision to accumulate or to distribute and the selection of the distributees is vested solely in the CORPORATE TRUSTEES. This is to assure that at all times the discretionary power will be vested in an Independent Trustee. For an excellent discussion of sprinkle trusts, see Lasser, Estate Tax Techniques, 1077.

The authority to pay life insurance premiums is commented upon in Item NINTH, paragraph (12), *infra.*

Note that with respect to the power to distribute principal to the wife it is suggested that this be done only after the principal of the marital deduction trust has been exhausted. The objective here is to have her first spend the capital that will be taxable at her death before dipping into the capital that will not form part of her taxable estate at her death.

FIFTH

Special Power of Appointment

Each child of mine, from and after the date of my wife's death, shall have power to appoint by deed or by Will the whole or any part of the principal of the trust established on his account to or among any one or more of the beneficiaries, other than himself, and other than the donee of any other special Power hereunder, of any of the trusts established by Item FOURTH of this my Will, in such amounts or proportions and in such lawful interests and estates, whether absolute or in trust, as such child may direct.

No child of mine shall have any power to appoint any part of the principal either directly or indirectly in such a way as to benefit himself, his estate, his creditors or the creditors of his estate. Further he shall have no power to appoint any policies of insurance or the proceeds of any policies of insurance on his life which such trust may own.

Any power conferred on any child of mine shall be exercisable by such child by instrument in writing delivered to the Trustees during the life of such child or by a specific reference to the power in the will of such child. Any such power shall be releasable in whole or in part by such child. In addition to other methods of release or reduction recognized by law, such power may be released or reduced by an instrument in writing delivered to the Trustees expressly declaring the intention of such child to release his power in whole or in designated part.

Comment: Under INT. REV. CODE OF 1954, § 2041, only property subject to a general power of appointment is includible in the estate of the donee of the power. By definition a special power is one which is not exercisable in favor of the donee of the power, his estate, his creditors, or the creditors of his estate. INT. REV. CODE OF 1954, § 2041(b). Here the power, exercisable by deed or will, is restricted to the trust beneficiaries. This may be preferable to a very broad class that excludes only the donee. See McCoid, *The Non-General Power of Appointment—A Creature of the Powers of*

Appointment Act of 1951, 7 VAND. L. REV. 53 (1953). The first sentence of the second paragraph is designed to make doubly sure that the power will not be construed as general. The second sentence is designed to avoid a possible contention that a power over the proceeds of a life insurance policy on the life of the donee might be construed as an indirect power to designate the beneficiary and hence be classified as an incident of ownership.

The inclusion of a special power adds considerable flexibility and gives the donee many of the privileges of ownership without the attendant tax burdens. See BOWE, TAX PLANNING FOR ESTATES 10 (rev. ed. 1955). On the use of powers generally see LASSER, ESTATE TAX TECHNIQUES 1117 (1955).

The "donee of any other special Power hereunder" is excluded from the class of appointees to avoid any contention that reciprocal powers have been created. This may be an unnecessary precaution in view of the second paragraph. On the subject of reciprocal or cross trusts, see Lehman v. Commissioner, 109 F.2d 99 (2d Cir. 1940), *cert. denied,* 310 U.S. 637 (1940); Newberry's Estate v. Commissioner, 201 F.2d 874 (3d Cir. 1953). This last case would seem to suggest that the cautious approach in this item may be wholly unnecessary.

SIXTH
Termination

Notwithstanding the directions heretofore given my CORPORATE TRUSTEE as to the distribution of income and principal, every trust established by this Will shall terminate, if it has not previously terminated, 21 years after the death of the last survivor of my wife, my children, and any grandchildren of mine in being at the date of my death.

Upon such termination my Trustees shall immediately transfer, convey, and pay over the principal of each of the trusts to the lineal descendants then living of the particular child of mine on whose account or on whose issue's account the particular trust was established, per stirpes, and if none, to my lineal descendants then living, per stirpes, and if none, to The Regents of the University of Arizona.

Should any share of any trust established hereby become vested (under the distributive provisions with respect thereto) in any minor beneficiary, then notwithstanding such vesting, the Trustees shall retain the share of such minor beneficiary in trust. The Trustees shall invest and re-invest such share, shall collect the income therefrom, and, after paying the expenses of the trust, shall apply to the support, maintenance, education, or use of the minor beneficiary so much of the net income or of the principal of such share as may be necessary or appropriate

(in the discretion of the Trustees) for such purposes until such beneficiary shall attain the age of 21 years (or until his prior death), at which time the Trustees shall pay over the entire principal of such share to such beneficiary (or to his personal representatives).

Comment: The first paragraph requires vesting within the period of the common law Rule Against Perpetuities.

The last paragraph is designed to avoid the necessity of a guardianship should any distributees be minors. That a trust may continue beyond the period of the Rule Against Perpetuities provided all interests vest within the period, see RESTATEMENT, TRUSTS, § 62 (1935).

SEVENTH
Administrative Provisions

The CORPORATE TRUSTEE shall be the custodian of the assets and funds constituting the trust estates; and it shall be responsible for the maintenance of adequate records showing the condition of the trust estates and the income and expenses thereof, and for the preparation and filing of all required accountings, reports, and tax returns. The records pertaining to the trusts shall be open at all reasonable times to inspection by the Individual Trustees, by any beneficiary of any trust, or by the representatives of any such person; and any such person shall have the right to demand annual accountings showing the administration of the trusts.

The Trustees may combine for investment purposes all or any part of the funds held in any or all of the trust estates, or may hold the funds of all such trust estates in a combined trust fund; but the Trustees shall be responsible for the maintenance of full records showing the receipts and disbursements, and the funds held for the benefit, of each separate and distinct trust estate, and showing the allocable proportion of any such combined trust fund which belongs to each such separate and distinct trust estate.

The decision of a majority of the Trustees (except where it is otherwise provided herein) shall control upon any matter arising in the administration of the trusts. Any dissenting or abstaining Trustee may be absolved from personal liability by registering his dissent or abstention with the records of the trusts; but he shall thereafter act with the other Trustees in any way necessary or appropriate to effectuate the decision of the majority.

Comment: The burden of day to day administration is placed on the CORPORATE TRUSTEE where it clearly should be. But, as

provision is later made for two individual trustees, the individual trustees can outvote and therefore control policy decisions. This puts the investment control in the hands of the individuals in the event of disagreement as to proposed purchases or sales in the event of a difference of opinion between corporate and family member-trustees. Item EIGHTH, which follows immediately, makes it again clear that this control shall not extend to discretionary powers over income or capital distributions and is designed to assure the tax advantages of the income sprinkle provisions of Item FOURTH.

EIGHTH
Certain Powers Vested Solely in Corporation Trustee

I have given the CORPORATE TRUSTEE of my residuary trusts certain discretionary powers over the distribution of income and principal to and among the beneficiaries; I desire to make it clear that, notwithstanding any of the general powers conferred upon my Trustees, no individual Trustee shall exercise or join in the exercise of such powers for his own benefit directly or indirectly. Whenever the participation in income or principal of a beneficiary who is also a Trustee is being considered or may be affected by other action under consideration, all decisions shall be made exclusively and solely by the CORPORATE TRUSTEE.

Comment: See last sentence of comment to Item SEVENTH.

NINTH
Trustee's Powers

I hereby expressly authorize and empower the Executors with respect to my estate and the Trustees with respect to each of the trusts herein created, in their sole and absolute discretion:

(1) To purchase or otherwise acquire, and to retain, whether originally a part of my estate or subsequently acquired, any and all stocks, bonds, notes, or other securities, or any variety of real or personal property, including stocks or interests in investment trusts and common trust funds, as they may deem advisable, whether or not such investments be of the character permissible for investments by fiduciaries, or be unsecured, unproductive, underproductive, overproductive, or of a wasting nature. Investments need not be diversified and may be made or retained with a view to a possible increase in value. The Executors or the Trustees may at any time render liquid my estate or the trust estates, in whole or in part, and hold cash or readily

marketable securities of little or no yield for such period as they may deem advisable.

Comment: Most lawyers and trust officers, remembering the depression of the thirties and the inflation of the forties believe it advisable to give the trustees the broadest possible investment powers. The power to hold cash uninvested and to purchase underproductive property (growth stocks) may prove particularly valuable. Note that such powers will not adversely affect the marital deduction bequest because of the specific limitations contained in Item THIRD with respect to underproductive property.

(2) To sell, lease, pledge, mortgage, transfer, exchange, convert, or otherwise dispose of, or grant options with respect to, any and all property at any time forming a part of my estate or of the trust estates, in such manner, at such time or times, for such purposes, for such prices and upon such terms, credits and conditions as they may deem advisable. Any lease made by the Executors or by the Trustees may extend beyond the period fixed by statute for leases made by fiduciaries and beyond the duration of the trusts.

Comment: Standard clause. Note power to lease beyond the duration of the trust. Cf. Nashville Trust Co. v. Lebeck, 270 S.W. 2d 470 (Tenn. 1954).

(3) To borrow money for any purpose connected with the protection, preservation or improvement of my estate or of the trust estates whenever in their judgment advisable, and as security to mortgage or pledge any real estate or personal property of which I may die seized or possessed or forming a part of the trust estates upon such terms and conditions as they may deem advisable.

Comment: Standard clause.

(4) To vote in person or by general or limited proxy with respect to any shares of stock or other securities held by them; to consent, directly or through a committee or other agent, to the reorganization, consolidation, merger, dissolution, or liquidation of any corporation in which my estate or the trust estates may have any interest, or to the sale, lease, pledge, or mortgage of any property by or to any such corporation; and to make any payments and to take any

steps which they may deem necessary or proper to enable them to obtain the benefit of such transaction.

Comment: Standard clause.

(5) To hold investments in the name of a nominee.

Comment: The purpose of nominee ownership is to avoid the necessity on a sale of securities for an examination of the trust instrument by the corporation or its transfer agent, with resulting delay. The speed-up in transfer ability may be very important in a rapidly fluctuating market. So long as the CORPORATE TRUSTEE holds the physical securities there is little risk of wrong-doing.

Many of the powers expressly given merely echo existing statutory provisions. It nevertheless seems wise to recite them in the instrument since the authority of the trustees may then be determined by reading the will without the need for recourse to the statutes. Further the existing law may be amended or revoked. It is also possible that the law of some other jurisdiction may be determinative if the decedent should change his domicile prior to death or if the trusts acquire real estate situated in some other jurisdiction.

(6) To complete, extend, modify, or renew any loans, notes, bonds, mortgages, contracts, or any other obligations which I may owe or to which I may be a party or which may be liens or charges against any of my property or against my estate, although I may not be liable thereon, in such manner as they may deem advisable; to pay, compromise, compound, adjust, submit to arbitration, sell, or release any claims or demands of my estate or the trust estates against others or of others against my estate or the trust estates as they may deem advisable, including the acceptance of deeds of real property in satisfaction of bonds and mortgages, and to make any payments in connection therewith which they may deem advisable.

Comment: Standard clause.

(7) To apportion receipts and disbursements of my estate or the trust estates between principal and income in such manner as they may deem advisable, in their absolute discretion, including the power to pay as income, if they see fit, the whole of the interest, dividends, rent, or similar receipts

from property, whether wasting or not and although bought or taken at a value above par; to treat as income or principal or to apportion between them stock dividends, extra dividends, rights to take stock or securities and proceeds from the sale of real estate, although such real estate may have been wholly or partly unproductive.

Comment: The power to apportion receipts and disbursements to income or principal eliminates any necessity for applications to the court in doubtful cases and enables the trustee to do substantial justice as between life tenant and remainderman without being restricted by arbitrary rules of law. The power is of less importance where, as here, the CORPORATE TRUSTEE is given broad discretionary powers over income and principal distributions. Its inclusion, nevertheless, seems desirable.

(8) To employ agents, experts, and counsel, investment or legal; even though they may be associated with, employed by, or counsel for any of the Executors or Trustees or any of the beneficiaries of my estate or the trust estates; and to make reasonable and proper payments to such agents, experts, or counsel for services rendered.

Comment: Standard clause.

(9) To accept beneficial employment with or from any business in which my estate or the trust estates may be interested, whether by way of stock ownership or otherwise, and even though the interests of my estate or the trust estates in said business shall constitute a majority interest therein, or the complete ownership thereof; and to receive appropriate compensation from such business for such employment.

Comment: This may be important to the family trustees where the trust owns a substantial block of stock in a family corporation.

(10) To sell to or purchase assets from any trust or estate, in which any of the beneficiaries of any of the trusts established by this my Will may be interested, including sales by one of the trusts hereby established to any other one of the trusts hereby established.

Comment: Occasionally it may be desirable to shift assets from

one trust to another. Thus if cash is needed in one of the trusts a sale of one of its assets to another trust may be made, without losing family control over the asset.

(11) To purchase from, sell to, or otherwise deal with any corporation, association, partnership, or firm with which any of them may be affiliated, or in which any of them may in any other way be interested, as freely as they might or could deal with an independent third party, and without any greater responsibility, all rules or provisions of law to the contrary being hereby expressly waived.

Comment: Like paragraph (9) above this power may be important where family businesses are likely to have transactions with the trusts.

(12) To purchase policies of insurance on the life of any beneficiary of any trust, or on the life of any other person in whom any trust may have an insurable interest, and to continue in effect or to terminate any life insurance policy which may be owned or held by any trust; and to pay (from income or principal) any premiums or other charges, and to exercise any and all rights or incidents of ownership, in connection therewith.

Comment: Income used to pay premiums will be taxed to the trustee. The purchase of such insurance relieves the beneficiaries of the personal need to carry insurance which would have to be paid for out of income after it had been subjected to their top income tax brackets. Further it eliminates any estate tax on the proceeds since the trusts own the policies. The insurance, nevertheless, may serve the usual objective of making cash available to the family for death costs through the power of the CORPORATE TRUSTEE to distribute principal or by a purchase of assets from the estate of the insured decedent.

(13) To pay over all or any part of any net income or principal which the CORPORATE TRUSTEE has determined (in the exercise of his discretion) to distribute to or apply for the benefit of any beneficiary who is a minor or who is legally incapacitated to the legal custodian or to the parents or a parent of such beneficiary, or to any person with whom such beneficiary shall reside at the time; and

the receipt or acquittance of such payee shall be a complete discharge of the Trustees with respect to any payments so made, and the Trustees shall not further be required to see to the application of such payments.

Comment: Avoids necessity for Guardianship.

(14) To make distribution of my estate or of the principal of the trust estates in kind or partly in kind and to cause any share to be composed of cash, property or undivided fractional shares in property different in kind from any other share.

Comment: Standard clause.

(15) To execute and deliver any and all instruments in writing which they may deem advisable to carry out any of the foregoing powers. No party to any such instrument in writing signed by the Executors or by the Trustees shall be obliged to inquire into its validity, or be bound to see to the application by the Executors or by the Trustees of any money or other property paid or delivered to them pursuant to the terms of any such instrument.

Comments: Standard clause.

TENTH
Tax Clause

I direct my Executors to pay all federal and state estate, inheritance, succession, transfer, or other death taxes which are assessed against my estate or against any beneficiary (including estate and inheritance taxes assessed on account of life insurance proceeds or any other property which shall be included in my gross estate for the purpose of such taxes, whether or not included in my estate for probate purposes) out of that portion of my residuary estate described in Item FOURTH of this my Will.

Comment: No will should be written without a tax clause. The Federal Code requires that, absent a contrary provision in the will, life insurance and property subject to a general power of appointment, shall bear their share of the Federal estate taxes, INT. REV. CODE OF 1954, §§ 2206, 2207. Beyond that the matter is left to local law. Speaking generally, taxes are payable from the residuary estate

unless the testator manifests a contrary intent or the domiciliary state has an apportionment act. Many, if not most states, require appointment. The problem is further complicated by the inclusion of non-probate assets in the taxable estate, i.e., jointly held property, gifts in contemplation of death, etc.

There is no rule of thumb as to the desirable clause. Some testators want each beneficiary to bear his share; others would have it paid from the residue; others would exclude lifetime transfers from the burden. Because of the heavy impact of taxes the entire testamentary plan may be distorted if the matter is not fully discussed with the testator and a clause drawn that will satisfactorily carry out his wishes. See 3 Rabkin and Johnson, Current Legal Forms With Tax Analysis 603 (1955).

ELEVENTH
Authorization to File Joint Income and Gifts Tax Return

I specifically authorize my Executors to elect to file a joint return of income with my widow for any period or periods for which such a return may be permitted following my death and to pay from my estate the full amount of the tax due on such return or any adjustment thereof; and to consent that any gifts made by me or by my wife prior to my death shall, for gift tax purposes, be considered as having been made half by me and half by my wife, and, if such consent be given, to pay from my estate any and all gifts taxes that may be due because of such gifts.

Comment: Absent this clause the executor may hesitate to assume the liabilities involved. By filing a joint income tax return the executor becomes liable for the full tax, including any later assessments and penalties.

TWELFTH
Simultaneous Death

In the event my wife and I die under such circumstances that there is no sufficient evidence to establish who survived the other, I hereby declare my wife shall be presumed to have survived me and that this Will and all its provisions shall be construed upon that assumption and basis.

Comment: In the past it has been rather common to insert clauses in wills to the effect that if the testator and beneficiary perish in a common disaster, it shall be presumed that testator survived. The

reason for this was to avoid heavy successive death taxes on the almost simultaneous transmission of wealth through two estates. If such a clause results in the failure of a bequest to a spouse, the intended marital deduction will be completely lost. It, therefore, may, in some situations, be advisable to reverse the usual clause and provide that in the event of the deaths of both spouses under such circumstances that it cannot be determined who survived, the other spouse shall be presumed to have survived the testator. The Regulations, Section 20.2056 (e)—2 (e), provide as follows: "If the order of deaths of the decedent and his spouse cannot be established by proof, a presumption (whether supplied by local law, the decedent's will, or otherwise) that the decedent was survived by his spouse will be recognized as satisfying paragraph (b) (1) of Section 20.2056 (a)—1, but only to the extent that it has the effect of giving to such spouse an interest in property includible in her gross estate . . ."

THIRTEENTH

Successor Trustees

Realizing that my Individual Trustees may die, resign, or become incapacitated and that my CORPORATE TRUSTEE may resign and further realizing that unforeseen contingencies, conflicts, real and imagined, among my Trustees, lack of harmony and other events may make it desirable at some time in the future to remove one of my Trustees, I hereby authorize any two of my Trustees, whenever it is in their judgment in the best interests of the trusts, to remove the third Trustee provided (a) that if one of my Individual Trustees be removed, or resigns, dies, or becomes incapacitated, the other Individual Trustee shall designate his successor and (b) if the CORPORATE TRUSTEE be removed, or resigns, his successor shall be another CORPORATE TRUSTEE with assets of at least $5,000,000, appointed by unanimous action of my two Individual Trustees. It is my wish and I direct that there shall always be two Individual Trustees and one CORPORATE TRUSTEE, acting as Co-Trustees. If my Individual Trustee, or Trustees, as the case may be, shall fail for any reason to designate a successor, or successors, then upon such failure to act of such Trustee or Trustees, successor Trustee or Trustees may be designated by a majority of the adult beneficiaries currently entitled in the discretion of the Trustees to receive income from the trusts established in this my Will.

Comment: Because of the long duration of the trusts, provision is made for successor trustees. The power of removal gives the family trustees some control over the CORPORATE TRUSTEE. This may

be important since the personnel actually administering the trust for the CORPORATE TRUSTEE will change from time to time and occasionally not in the best interests of the beneficiaries. At any rate testators may so think. A clause such as this overcomes much of the objection many people have to a corporate trustee. It is believed that the power to remove does not under present law adversely affect the tax savings through the sprinkle provisions since the successor must be another corporate trustee. But since one can never be sure how the law may develop Item FIFTEENTH contains an escape clause, whereby individual trustees who might be beneficiaries or regarded as subservient to the wishes of beneficiaries (should the law develop along these lines) may release this power.

FOURTEENTH
Waiver of Bond

I direct that my Executors shall not be required to file any inventory of my estate and that no Executrix, Executor, or Trustee shall be required to give any bond, and that if, notwithstanding this direction, any bond is required by any law, statute, or rule of court, no sureties be required thereon.

Comment: Standard clause. It seems perfectly safe to waive a bond since there will always be a financially responsible corporate trustee.

FIFTEENTH
Release of Powers

Any Trustee may release (in whole or in part, temporarily or irrevocably, and with respect to any one or more of the trusts) any power, authority, or discretion conferred upon him, by this my Will, by instrument in writing delivered to the other Trustees and to the adult beneficiaries of each trust involved. If the discretion to distribute, apply, or accumulate income is released by the CORPORATE TRUSTEE upon whom it is conferred, the entire net income of the trust shall thereafter during the period such release is effective be distributed:

(a) to my wife during her life and after her death,

(b) to that child of mine, because of whom the trust was established, during his life and after his death,

(c) equally to and among his spouse and lineal descendants, per stirpes, the spouse to have a child's share and if and when none shall be living,

(d) to my lineal descendants then living, per stirpes.

Comment: This is an escape clause designed to protect against future changes in the tax law which might make it desirable for the trustees or some of them to release certain powers. Thus in the event that Congress should impose a burdensome tax on sprinkle trusts (to compensate for the tax savings now available) this clause provides an escape. It also provides for temporarily releasing powers so that if one of the individual trustees expects to be away for a long period he can in effect delegate his powers during his absence.

SIXTEENTH

Executors and Trustees

I hereby nominate and appoint my son, Richard Sprinkle; my son-in-law, John Doe, and the Third Commerce Bank of Special Power, Tax Haven, to be the executors and trustees of this my will.

SEVENTEENTH

Identification of Children

The only children of mine now living are my son ____________________,

who was born, ____________________, and my daughter ____________________,

who was born, ____________________, but wherever herein my children are referred to it is my intention to include not only my children above named, but any other children who may be born to my wife and me, or adopted by us.

EIGHTEENTH

Freedom from Jurisdiction of Probate Court

It is my intention and desire that the trusts herein provided for shall be administered free from the jurisdiction and control of the court having jurisdiction of the settlement of my estate, and that said court shall not continue the administration of my estate after the payment in full of all debts, devises, and legacies, except the trust fund or property of the trusts herein provided for, and that such court shall proceed to final settlement of my estate as in other cases and order the trust fund or property to be turned over, conveyed, and delivered to my trustees as such.

IN WITNESS WHEREOF,[1] I, ______________________________

have to this my Last Will and Testament subscribed my name and

seal this ______ day of ____________________, in the year of Our

Lord One Thousand Nine Hundred and ______________________.

______________________________(L.S.)

This instrument consisting of ____________________ (   ) pages, was subscribed and sealed by the Testator in the presence of us and of each of us, and at the same time published, declared and acknowledged by him to us to be his Last Will and Testament, and thereupon we, at the request of the said Testator, in his presence and in the presence of each other, have hereunto subscribed our names as witnesses this

__________________ day of ____________________, 19______.

________________________ residing at ________________________

________________________ residing at ________________________

________________________ residing at ________________________

[1] The usual Spendthrift Clause has been purposely omitted. The sprinkle provisions with respect to both income and principal make such a clause wholly unnecessary. Indeed the sprinkle clause has for hundreds of years been the English practitioner's method of protecting the assets from the claims of a beneficiary's creditors.

Draftsmen would do well to avoid the routine inclusion of spendthrift clauses in wills, absent some real reason for using this device. They seem to be always included as clauses that can do no harm but may upon some extremely remote contingencies prove beneficial. Their presence, however, frequently comes as a shock to donors, who in reliance upon Blair v. Commissioner, 300 U.S. 5 (1937), have wanted, for income tax reasons, to assign their life interests in trusts. Under the *Blair* doctrine an assignment of a life interest in a trust may effectively shift the income tax to the donee. But if such an assignment is ineffective under state law, as is true when the spendthrift clause is used, the donor is precluded from shifting the tax burden.

Perpetuities in Arizona

RICHARD R. POWELL*

Ladies and Gentlemen of Arizona:

My pleasure in being with you for this conference has many bases. It is a real joy to renew an old acquaintance with Professor Lenoir and his delightful family. There is great promise of new friends in this opportunity to meet the representative leaders of your bar. The change from the climate of New York at the end of February to the climate of your state at the same period provides a credit entry on the ledger. Basically, however, my desire to be here at this time rests upon my hope that I can provide you with adequate reasons for an early statutory modification of five sections in the Arizona Revised Statutes of 1956, namely, §§ 33-229(B), 33-230(A), 33-232(B), and most important of all, §§ 33-235 and 33-261.

These sections constitute a 1913 borrowing by Arizona from the statutes of Wisconsin, which had in turn been borrowed from Michigan in 1849, which had in turn been taken from the New York Revised Statutes of 1830. Thus I come to you from New York, seeking to prevent you from reaping the undesirable harvest of a mistaken confidence in the New York innovations made thirteen decades ago. Despite the genuine and interesting antiquity of your Spanish and Indian heritages, the fact remains that on the problems involving the Rule Against Perpetuities, yours is a young state. Accumulations of wealth among your citizens are growing more significant day by day, but the number of wealthy persons who have heretofore died resident in your state is relatively small, even in proportion to your population. This means that you have not yet had the accumulation of bitter experiences with the New York-derived rules on this topic which have caused every other erstwhile follower of New York's statutory innovations of 1830 on this topic to backtrack either by decisions or by legislative action. Even New York itself, in 1958, abandoned the two-life provision for multiple lives. While your body of decisions on this topic is still small is the time when a change to a more workable rule can be made with a minimum of dislocations.

Any important change in statutory law requires a basic acquaintance with what exists, so that the "operation" can be judged wisely as to its necessity, and if found necessary, can be executed with a minimum of

* See Contributors' Section, p. 284, for biographical data.

shock to the body of the law. I propose, therefore, (a) to trace quickly the evolution of the common law Rule Against Perpetuities in England, since that constitutes presently the Arizona law applicable to all disposition of personal property, except estates for years; (b) to outline sketchily the changes injected into the law on this topic by the New York Revised Statutes of 1830, as interpreted by the New York courts, until modified slightly by a statute of 1929, and drastically by a statute of 1958; (c) to deal briefly with the partial borrowing of the New York system by the Revised Statutes of Michigan enacted in 1846, and made bearable by judicial interpretation down to the restoration of the common law made by statute of 1949; (d) to discuss the Wisconsin borrowing of the Michigan statutes of 1849, and the mitigation of their hardships down to the Wisconsin return to the common law rule in 1927; and then to present the Arizona constitutional provision barring perpetuities, dating back to 1851, the provision of the Howell Code of 1864 receiving the common law, followed by the partial abrogation thereof by the Arizona borrowing of statutes in 1913 from Wisconsin, which was in turn followed in the succeeding five decades by a handful of Arizona decisions dealing with scattered aspects of this broad topic.

Going back even to the late seventeenth century does not suffice to find the real beginnings of the common law Rule Against Perpetuities. For centuries prior to that, English judges had been astute in throttling at birth the efforts of lawyers and of dynasty-minded families to curtail the alienability of their chief type of asset, namely, land.

This struggle, however, appeared in a new context during the seventeenth century. Conveyancers undertook to create indestructible future interests, and the question had to be soon faced as to how far this practice could be extended without "inconveniently" lessening the alienability of land. The ultimately affirmed opinion of Lord Nottingham in the *Duke of Norfolk's Case,*[1] decided in 1682, started the ball rolling. He decided that an elimination of alienability for the duration of one life, incident to the creation of an indestructible future interest, was not "too long," was not so long as to require a prohibition based on social policy. At the same time he issued an invitation typical of common law. Said he, in effect, get busy, lawyers. Work out limitations of this type operative for varying periods of future time. As each is litigated, the courts will hold it good or bad. Eventually the resultant body of decisions will establish the outer limit of goodness. The next century and a half exemplified this process of trial, followed sometimes by success, sometimes by invalidity.

In 1697, *Lloyd v. Carew*[2] found two lives plus one year *not* too long.

[1] 3 Ch. Cas. 1, 22 Eng. Rep. 931 (1682).
[2] Show. P.C. 137, 1 Eng. Rep. 93 (1697).

In 1736, *Stephens v. Stephens*[3] sustained the use of a period measured by one life plus a minority of a person in being when the first life ended. In 1797, *Long v. Blackall*[4] added the refinement that the measuring life might be lawfully both preceded and followed by a period of gestation without incurring the misfortune of ineffectiveness.

In 1805, the great case of *Thellusson v. Woodford*[5] was decided under the will of a thrifty Swiss who had accumulated a great fortune in English business; had been appalled at the consequences of new wealth on his own offspring; had conceived the notion that later generations among his issue might prove better than those he knew; and, in the light of these convictions, had postponed the ascertainment of his ultimate distributees until the death of the survivor of nine persons, two of whom were *en ventre sa mere* at his death, and none of whom were ever to get any corpus or any income. The court decided that the permissible period, under both the Rule Against Perpetuities and the rule against accumulations, could be measured by multiple lives of persons in being when the instrument spoke, provided only that the persons so used were neither so numerous, nor so chosen as to make it inconveniently difficult to ascertain the death of the survivor. It declared that the measuring lives need not be persons benefitting in any way from the limitation, and that the possibility of a gestation period at the beginning and at the end of the multiple lives did not invalidate the limitation.

The final landmark in this tale of judicial legislation was *Cadell v. Palmer,* decided in the lower court in 1827, and finally affirmed in 1833.[6] In this case the sustained period was measured by twenty-eight lives plus a term in gross of twenty years. The theory as to the added term in gross was that it was not longer than the then already long permitted minority following lives in being.

Thus as the result of six landmark cases, stretching over a span of a century and a half, the permissible period under the common law Rule Against Perpetuities became crystallized at (a) lives of persons in being when the limitation spoke (within an outer limit as to number fixed by the evidence rule); plus (b) a period of twenty-one years; plus (c) such periods of gestation as might be called for by the circumstances of the persons affected. This is the permissible period stated and discussed in section 374 of the *Restatement of the Law of Property.*

[3] Cas. t. Tal. 228, 25 Eng. Rep. 751 (1736).
[4] 7 Term R. 100, 101 Eng. Rep. 875 (1797).
[5] 11 Ves. 112, 32 Eng. Rep. 1030 (1805).
[6] Bengough v. Edridge, 1 Simon 173, 57 Eng. Rep. 544 (1827); affirmed as Cadell v. Palmer, 1 C. & F. 372, 6 Eng. Rep. 956 (1833).

This is the period still in use in most of the United States. This is the period governing in Arizona all dispositions of personal property (other that estates for years). More, however, on this aspect of Arizona law, a bit later in this address.

The common law had another problem demanding solution. From the beginning it had been clear that any limitation which *suspended the power of alienation* for longer than the permissible period would be declared invalid. Most of the decisions both in England and in the early American days were of this sort. Sometimes, however, a limitation which made no suspension of the power of alienation for too long a time did in fact lessen the probability of alienation by creating indestructible future interests involving uncertainty as to the ultimate takers which could last for longer than the permissible period. For example, *A*, by will, created a trust for the benefit of his son *B* for life, with an ultimate distribution of the trust's corpus "to those children of *B* who reached the age of thirty years." By *B's* death, all of *B's* own children were either alive or at least conceived. By nine months after *B's* death there were certain to be in existence persons who by joining could (if they chose) convey complete ownership. Hence the *power of alienation* was not too long suspended. The common law courts held, however, that the policy of the Rule Against Perpetuities to protect society against lessened alienability was broad enough to cover such cases. Thence grew the broad applicability of the common law rule to future interests, popularized by John Chipman Gray in terms of "remoteness of vesting."

Let us now turn our attention to the State of New York. Down to 1830 no English speaking jurisdiction had adopted a topically organized set of statutes. The law of each jurisdiction consisted of a fluid and adaptable body of judicial precedents, with scattered statutory factors, immensely important when applicable but operative as to almost a negligible percentage of the whole area covered by law. Jeremy Bentham had begun as a voice crying in the wilderness in 1776, advocating codification and more codification as a cure-all for the unpredictability of judge-made law. On the Continent of Europe, Bentham found enough disciples to make him largely responsible for the French Code, first published in 1803, and for the Codes of Louisiana, adopted in 1808 and 1825. The Bentham bug was on the loose in New York and Benjamin Butler and John Duer became convinced as to the wisdom of a topically organized system of statutes. Due to the influential political connections of these two gentlemen, the Legislature authorized their project. The New York Revised Statutes of 1830 were the product. This two volume compilation was a milestone in Anglo-American jurisprudence. It was the first codification of substantially the whole area of a state's law,

organized on a more or less scientific basis. Their work begat the large and expensive statute alcoves in modern American law libraries.

The revisers had envisaged their task as chiefly one of restatement, that is, the putting into succinct words of the existing rules as established theretofore, chiefly by decisions, but partly also by statutes. From time to time, however, they felt the surge of a spirit of reform, and, on such occasions they formulated what they conceived to be "improvements" in the pre-existing fabric. In dealing with the topic of the Rule Against Perpetuities, the revisers acted partly as "restaters" and partly as "innovators." An awareness of exactly what they did produce is an essential step in understanding the present content of Arizona law.

In making a topical organization of the statutes they had one chapter devoted to real property and a separate chapter devoted to personal property. The provisions of the real property chapter on perpetuities were quite detailed. In setting forth the types of transactions subject to the rule's regulation, the restatement approach predominated. It was declared that the rule applied to limitations "suspending the power of alienation." Such limitations included the bulk of the cases governed by the rule at common law. But the revisers knew that the common law rule had been more inclusive than this. Hence they sought to encompass this additional area by a subsequent section which required that a fee "limited on a fee" be "upon a contingency which, if it should occur, must happen within the" period established by the statute as permissible. This section was later correctly construed by the highest court of New York to have incorporated into the New York statutory system, the so-called "remoteness" ingredient of the common law.[7] Provisions worded somewhat differently but similar in effect were inserted in the separate chapter on personal property. Thus far the revisers had endeavored merely to restate the rule as they found it.

The New York revisers innovated with a vengeance, however, in shortening the permissible period of the rule. They permitted only two lives instead of the multiple lives allowed at common law. They banished completely the term in gross, which had become fixed in England at twenty-one years during the 1820's. They permitted the employment of a minority only in dispositions of land, and only when the land had been given to a minor, with a gift over on the death under age of the first recipient. In passing it should be noted that this restricted minority also became permissible as to dispositions of personalty in 1929.[8] This wholesale shortening of the rule's permissible period has been the

[7] Matter of Wilcox, 194 N.Y. 288, 87 N.E. 497 (1909).
[8] N.Y. Sess. Laws 1929, c. 229, §§ 18, 21, amending N.Y. PERS. PROP. LAW § 11.

aspect of the New York statutory system most seriously troublesome in later decades.

The New York revisers further innovated by formulating new rules regulating the creation of estates for life which were the prototypes of Arizona Revised Statutes of 1956, §§ 33-229(B), 33-230(A) and 33-232(B).

Another new feature of the New York Revised Statutes of 1830 was a provision making inalienable the interest of a beneficiary of a trust to receive and apply income. It is doubtful whether this section was intended to have as drastic consequences as the New York courts attributed to it. In two decisions made respectively in 1835[9] and 1836,[10] it was decided that this section caused the affected trusts to "suspend the power of alienation"; and, consequently caused such trusts to be invalid if created to last for longer than the statutorily shortened permissible period. It can readily be seen that this judicial application of the Rule Against Perpetuities to the type of trust most commonly created gave the rule an applicability much more restrictive than had existed at common law.

It is not useful to take the time of Arizona practitioners to recount the details of the struggles in New York lasting over a century and a quarter to live with the incubus thus placed on reasonably desired familial dispositions of property. The New York courts labored manfully to mitigate its hardships (a) by changing established rules of construction for the salvaging of disposition; and (b) by largely emasculating the restrictions imposed on the use of a minority as an ingredient in the permissible period.[11] Finally, a crescendo of protests[12] brought about ameliorative legislation in 1958. From and after September 1, 1958, the two-life limit has been replaced in New York by multiple lives, within the limits of the evidence rule established at common law.[13]

Westward migrations from the early northern states followed the channel of the Erie Canal to Buffalo and the routes of the covered wagons thereafter. Thus New York legal experience played a large role in the early decades of Michigan, Wisconsin, Minnesota, and the Dakotas. Shortly after Michigan became a state in 1837, it adopted a compiled code, modelled in many particulars on the then recent New York legislation. The identity of substance with respect to the law of land was greatly increased in the Michigan Revised Statutes of 1846. The exact scope of this Michigan borrowing was importantly determinative of

[9] Coster v. Lorrillard, 14 Wend. 61 (N.Y. 1835).
[10] Hawley v. James, 16 Wend. 61 (N.Y. 1836).
[11] See Matter of Trevor, 239 N.Y. 6, 145 N.E. 66 (1924).
[12] 1936 N.Y. Law Rev. Comm. Rep. 491-608; Powell, Real Property ¶ 807, n. 30 (1956).
[13] N.Y. Sess. Laws 1958, chs. 152, 153.

the present law of Arizona. It has four significant aspects. In the *first* place Michigan borrowed *only* provisions contained in the New York chapter on *Real* Property. This led to the problem common to Michigan, Wisconsin, and Arizona, as to what this partial borrowing did with respect to the Rule Against Perpetuities concerning dispositions of personalty. Michigan early decided it had two rules: the borrowed statute as to land and estates for years and the common law rule continued as to all other personalty.[14] In the *second* place, Michigan in its land borrowings omitted the "fee on a fee" section of the New York statutes which provided the peg in New York for the "remoteness" ingredient in the rule. In consequence the Michigan statutory rule applied only to "suspensions of the power of alienation," and had no governing force as to remote and indestructible future interests in land, not suspending that power.[15] This position narrowed the destructive force of the otherwise tight statutory rule, but is of questionable wisdom, if the rule is to serve genuinely as a protection against the dead hand. In the *third* place, Michigan borrowed the section making inalienable the interest of the beneficiary of a trust to receive and to apply income, and, because of this, found that the statutory permissible period applied to the duration of such trusts.[16] In the *fourth* place, Michigan borrowed the New York innovations restricting the creation of estates for life. Thus as to land Michigan had a statute almost, but not quite, as tight as New York had had. This tightness was practically mitigated, however, by an early decision that the survivor of several persons meant only one life,[17] and by extraordinary liberality in resorting to equitable conversion of land dispositions, thus making applicable the more liberal permissible period of the common law applicable to dispositions of personalty.[18] Despite these ameliorative factors, Michigan, in 1949, repealed its statutory borrowings from New York on the Rule Against Perpetuities and restored the common law rule to full applicability to dispositions of all types of property.[19]

As might have been expected, Wisconsin, which had been a part of the Territory of Michigan after 1818, followed the grooves established by New York and Michigan. An early compilation of 1839, taken chiefly from New York, was followed, in the year following the attainment of statehood, by the Wisconsin Revised Statutes of 1849. These statutes had the same four significant aspects as have been discussed above in connection with Michigan, but the Wisconsin handling of the resultant problems was quite different. The borrowing of only the provisions

[14] Toms v. Williams, 41 Mich. 552, 2 N.W. 814 (1879).
[15] Torpy v. Betts, 123 Mich. 239, 81 N.W. 1094 (1900).
[16] Niles v. Mason, 126 Mich. 482, 85 N.W. 1100 (1901).
[17] Toms v. Williams, 41 Mich. 552, 2 N.W. 814 (1879).
[18] See Penny v. Croul, 76 Mich. 471, 43 N.W. 649 (1889).
[19] Mich. Sess. Laws 1949, Act 38.

relating to land led to an 1879 decision that Wisconsin had a statutory Rule Against Perpetuities applicable to land dispositions but no rule whatever governing dispositions of personalty other than estates for years.[20] The omission of the "fee on a fee" provision in the land statute had the same result as it had had in Michigan, namely, the exclusion of the "remoteness" ingredient.[21] As to trust duration, Wisconsin deviated from the New York and Michigan holdings, and followed the lead of a Minnesota decision of 1892[22] by holding that the "suspension of the power of alienation" injected by the statutory inalienability of the beneficiary's interest was eliminated by the presence of a discretionary power in the trustee to change the form of the trust res.[23] Meanwhile, the Wisconsin statutory permissible period had been enlarged by the addition, in 1887, of a twenty-one year term in gross.[24]

In the middle 1920's Wisconsin realized that it had very little of the social protections afforded elsewhere by the Rule Against Perpetuities. By decision it had no rule applicable to dispositions of personalty. By decisions it had liberalized the doctrine of equitable conversion so that most dispositions of land moved over into the unregulated area. By decisions it had rejected all regulation of trust duration, where the trust instrument authorized the trustee to sell and convey. By following the Michigan omission of the "fee on a fee" section in its real property law it had excluded the "remoteness" segment of the rule confining its statutory rule to dispositions found to have "suspended power of alienation." By statutes it had made generous exceptions of charitable gifts of land from regulation by the statute.[25] New legislation was obviously needed. The first step was taken in 1925, by legislation making the statutory period of two lives, plus twenty-one years applicable alike to dispositions of land and personalty.[26] This enactment, for the first time, brought home to Wisconsin lawyers the inconveniently tight character of this permissible period. Two years later, in 1927, Wisconsin eliminated this part of its New York heritage, substituting multiple lives, as had been allowed at common law, in place of its two-life limit, and an additional thirty years in gross in place of the twenty-one year term theretofore operative in Wisconsin.[27] Thus Wisconsin adopted the most liberal permissible period for the Rule Against Perpetuities existent in any Anglo-American jurisdiction. It has retained this dis-

[20] Dodge v. Williams, 46 Wis. 70, 50 N.W. 1103 (1879).
[21] Ford v. Ford, 70 Wis. 19, 33 N.W. 188 (1887).
[22] *In re* Tower's Estate, 49 Minn. 371, 52 N.W. 27 (1892).
[23] Beurhaus v. City of Watertown, 94 Wis. 617, 69 N.W. 986 (1897).
[24] Wis. Sess. Laws 1887, c. 551.
[25] Wis. Rev. Stat. 2039 (1878); Wis. Sess. Laws 1905, c. 511.
[26] Wis. Sess. Laws 1925, c. 287.
[27] Wis. Sess. Laws 1927, c. 341.

tinction except for the 1931 enactment by Prince Edward Island, allowing lives in being plus sixty years.[28] In 1931, Wisconsin completed its elimination of the New York ingredient on this topic by repealing its statutes regulating the creation of estates for life.

All of the foregoing has been background—but needed background—for our discussion of the present law of Arizona on this topic.

Your relevant history begins in an Act of July 12, 1851, whereby the Territory of New Mexico borrowed the 1836 Texas constitutional prohibition of perpetuities. This enactment is now found in the Constitution of Arizona, Art. II, § 29. It provides:

> No hereditary emoluments, privileges, or powers shall be granted or conferred, and no law shall be enacted permitting any perpetuity or entailment in this State.

The small content of this admonitory clause makes its unnecessary to trace the Texas clause back into earlier appearances of similar language in the constitutions of Florida, North Carolina, and Tennessee.[29]

In 1863, the Territory of Arizona was split off from New Mexico. By Congressional action "all legislative enactments of the Territory of New Mexico not inconsistent with the provisions of this act, are hereby extended to and continued in force in the said Territory of Arizona until repealed or amended by future legislation."[30] An itinerant territorial government, sent out complete from Washington, arrived in Arizona on December 27, 1863. The five top officials were a governor from Maine, a secretary from New York, and three judges respectively from Connecticut, Iowa, and Michigan. The first legislative assembly of twenty-seven members included two persons born in Arizona, three persons from southern states, seventeen persons from northern states east of the Mississippi, two from Missouri, and one each from California, Mexico, and Germany. The first act of the legislative assembly empowered the Governor "to appoint a commissioner to prepare and report a code of laws for the use and consideration of the Legislature."[31] Associate Justice William T. Howell, fresh from the Michigan borrowings from New York, produced the "Howell Code" modelled on the laws of New York, Michigan, and California. By Chapter 61 of this Code, which became effective November 10, 1864, all of the Spanish, Mexican, and New Mexican background of law was swept away and the following provision was adopted:

[28] 21 & 22 Geo. V. c. 15, now P.E.I. Rev. Stat. c. 108 (1951).
[29] Gerdes, *Perpetuities in California,* 16 Cal. L. Rev. 81 (1928).
[30] Thorpe, Constitutions (1909) 1, at p. 260.
[31] Laws, Arizona, 1864, at p. 19.

> The common law of England, so far as it is not repugnant to, or inconsistent with, the constitution and laws of the United States, or the bill of rights or laws of this Territory, is hereby adopted, and shall be the rule of decision in all the courts of this Territory.

This enactment appears in a somewhat more guarded form in A.R.S. § 1-201 (1956), and now reads:

> The common law only so far as it is consistent with and adapted to the natural and physical conditions of this state and the necessities of the people thereof, and not repugnant to or inconsistent with the constitution of the United States or the constitution or laws of this state, or established customs of the people of this state, is adopted and shall be the rule of decision in all courts of this state.

This reception statute made the common law Rule Against Perpetuities at least the *paper* law of Arizona from November 10, 1864, to the new legislation of 1913, and still suffices to fill the gaps in the present statutory system on this topic with a common law ingredient.

In the first year of statehood (1913) Arizona borrowed the then operative Wisconsin statutes on perpetuities together with the Wisconsin sections regulating the creation of estates for life. This is the source of the present relevant statutes of this state. Section 33-261 is the chief and central section. It appeared originally in the Civil Code of 1913 as §§ 4679 and 4680. Some slight changes of wording and some transpositions of sentences have occurred since 1913, but the substance remains exactly as it was borrowed in 1913, except for a liberalization of the charity exception injected by statutes of 1921 and 1928.[32] The present wording of § 33-261 is as follows:

> A. The absolute power of alienation shall not be suspended by any limitation or condition for a period longer than during the continuance of two lives in being at the creation of the estate and twenty-one years thereafter, except in a grant or devise to a charitable, literary or cemetery use, and except in the instance specified by § 33-235.
>
> B. Every future estate which suspends the absolute power of alienation for a period longer than that specified in Subsection A is void in its creation.

[32] Ariz. Sess. Laws 1921, c. 141; Ariz. Code Ann. § 2761 (1928).

> C. The absolute power of alienation is suspended when there are no persons in being by whom an absolute fee in possession can be conveyed.

It will be noted that this statute imposes its restricted permissible period only on dispositions of land and is applicable only when such a disposition suspends the power of alienation. Stated negatively it applies neither to dispositions of personalty, except future interests in a term of years,[33] nor to dispositions of land involving "remoteness" rather than suspensions of the power of alienation. The text of the statute, as given above, includes the twenty-one year term in gross taken in 1913 from the Wisconsin legislation of 1887.[34] This inclusion made the continued existence of what is now Section 33-235[35] completely meaningless. No situation can come within the restricted minority period allowed by § 33-235, which is not fully covered by the twenty-one year period in gross allowed by subsection A of § 33-261. Thus your law would be in no way changed by the complete repeal of present § 33-235 and the reference to that section in § 33-261.

The regulations on the creation of estates for life, first produced by the imaginations of the 1830 New York revisers, and later imported by Wisconsin in 1849 from Michigan, appeared in the Arizona Civil Code of 1913 as §§ 4682-4686. This material has been scattered into the subsections of present §§ 33-229, 33-230, and 33-232. Some parts of this borrowing from New York are wholly innocuous. Other parts of it hang on the peg of the two-life rule and serve no useful purpose. Let us examine these sections for the purpose of separating the good grain from the chaff.

Section 33-229 has two parts:

> A. A remainder shall not be created upon an estate for the life of any person other than the grantee or devisee of the life estate unless the remainder is in fee, nor shall a remainder of a term of years be created upon an estate for the life of any person other than the grantee or devisee of the life estate unless it is for the whole residue of the term.

This first part of the section is not open to any serious objection. It prohibits limitations not likely ever to be made. It serves no discoverable purpose, but it has no real vice.

33 A.R.S. § 33-262 (1956) which embodies CIVIL CODE § 4688 (1913).
34 Wis. Sess. Laws 1887, c. 551.
35 Which embodies CIVIL CODE § 4681 (1913).

> B. When a remainder is created upon a life estate for the life of any person other than the grantee or devisee, and more than two persons are named during whose lives the life estate shall continue, the remainder shall take effect upon the death of the two persons first named as if no other lives had been introduced.

This subsection B of § 33-229 is a corollary of the two-life principle embodied into § 33-261. Any change of § 33-261 to a more rational form, requires the repeal of this subsection B.

Section 33-230 also has two parts:

> A. A contingent remainder shall not be created on a term for years unless the contingency is such that the remainder must vest during the continuance of not more than two lives in being at the creation of the remainder or upon termination thereof.

This first part of the section is another corollary of the two-life principle embodied into § 33-261. Furthermore, the provision, as worded, perpetuates the Wisconsin failure to incorporate its twenty-one year term in gross into this, as well as into its principal section, and constitutes an anomalous incongruity in the existing statutes of Arizona. Any change of § 33-261 to a more rational form requires the repeal of this subsection A of § 33-230.

> B. No estate for life shall be limited as a remainder on a term of years except to a person in being at the creation of the life estate.

This subsection B of § 33-230 is innocuous. If anyone likes it enough to draw a repealing statute applicable only to subsection A, no real harm will result from the continuance of subsection B.

Section 33-232 also has two parts:

> A. Successive estates for life shall not be limited unless to persons in being at the creation thereof.

This is a restrictive provision generated in New York in 1830. It had no counterpart in the common law, but it has been harmless for a century and a quarter in New York and it may well prove equally innocuous for Arizona.

> B. When a remainder is limited upon more than two successive

> estates for life, all the life estates subsequent to the first two are void, and upon the death of those first two persons, the remainder shall take effect as if no other life estate had been created.

This subsection B of § 33-232 is another corollary of the two-life principle embodied into § 33-261. Its fate should depend upon your decision to keep, or to repeal that central section.

As I stated at the very beginning of this address, I strongly urge the prompt repeal of your present sections 33-229(B) (on life estates), 33-230(A) (on life estates), 33-232(B) (on life estates), 33-235 (on a minority as part of the permissible period), and 33-261, which is the basic section establishing the Arizona permissible period at two lives plus twenty-one years. In the place of these unfortunate takings, immediately from Wisconsin, but ultimately from New York, you would be well-advised to follow the examples of the states from and through which you made the borrowings. New York, just last year, restored multiple lives instead of its erstwhile hamstringing two; Michigan restored completely the common law permissible period, ten years ago; Wisconsin restored the common law permissible period and lengthened it to multiple lives plus thirty years, twenty-two years ago. Michigan and Wisconsin have both repealed their sections embodying the two-life principle into their regulations of estates for life. Arizona, by following in the footsteps of Michigan, New York, and Wisconsin, would also be bringing its law into closer conformity to the common law, which has continuously functioned in most of the United States, including the important states of Illinois, Massachusetts, New Jersey, and Pennsylvania, and which has become the guiding principle in the great State of California.

Why should Arizona take this action, and take it now? Because you are a young state in your body of precedents on this topic. Because you have not yet experienced the crippling consequences of the two-life principle and you can avoid that pain and travail, if you act promptly.

I have searched the reported decisions of your supreme court for holdings in this field. The earliest important case is *Lowell v. Lowell.*[36] Dr. Percival Lowell had died in 1916 leaving an estate, valued at about $2,000,000, which included some land, but much personalty. His will created a trust which comprised both land and personalty. As to the personalty, the Court declared it wholly governed by the common law; but as to the land, resort must be had to the statutes "lifted bodily from the statutes of Wisconsin" in 1913. Do you see the germs of future trouble implicit in this recognized bifurcation of your law? Residuary

[36] 29 Ariz. 138, 240 P. 280 (1925).

clauses typically deal with assets partly land, partly personalty. These dispositions of different types of property must be untangled, must be separated, and each part subjected to a different criterion of validity. When Michigan was faced with this question, it decided that if either part failed the whole failed as an inseparable entity.[37] This caused the whole of a residuary clause to fail in a 1938 case, where the personalty (as to which the common law rule applied) was worth over $56,000 but the land (as to which the statutory rule required invalidity) was only $800.[38] So long as Arizona has *two* rules, the common law rule applicable to personalty and a statutory tight rule applicable to land, you have in your law the seeds of serious trouble. In the *Lowell* case, your supreme court was able to sidestep this pitfall. The trust for charity, as to land, although then subject to the statutory short permissible period was found to be outside the statute because the power conferred on the trustee to sell the affected land, eliminated the "suspension of the power of alienation" otherwise implicit in the trust. This second half of the *Lowell* decision represents a tremendously important judicial contribution to your jurisprudence. It represented a following of judicial positions which had been taken in Minnesota in 1892[39] and in Wisconsin in 1897;[40] and repudiated the contrary position early adopted in New York[41] and thence crystallized in the statutes of California.[42] For all practical purposes, this decision freed Arizona largely from the necessity of measuring the duration of private land trusts by the statutory short permissible period. Seldom are such trusts created without conferring on the trustee discretionary power to sell and such a power sidesteps the statute. Thus the *Lowell* case deserves the term "significant" because it settled for Arizona (a) the continuance of the common law Rule Against Perpetuities, applicable to personalty, side-by-side with the borrowed statutory rule applicable to land; and (b) freed this state from the application of its shortened permissible period to trusts of land containing a discretionary power to sell the land.

Other than the *Lowell* case I have found only eleven decisions of the Arizona Supreme Court, dealing even remotely with the operation of the Rule Against Perpetuities in your state. Five of these are only indirectly significant, dealing as they do with aspects of the law of future interests out of which problems under the rule can emerge.

[37] Palms v. Palms, 68 Mich. 355, 36 N.W. 419 (1888).
[38] Richards v. Stone, 283 Mich. 485, 278 N.W. 657 (1938).
[39] *In re* Tower's Estate, 49 Minn. 371, 52 N.W. 27 (1892).
[40] Beurhaus v. City of Watertown, 94 Wis. 617, 69 N.W. 986 (1892).
[41] Coster v. Lorillard, 14 Wend. 265 (N.Y. 1835); Hawley v. James, 16 Wend. 61 (N.Y. 1836).
[42] CAL. CIV. CODE § 771 (1872).

Schornick v. Schornick, decided in 1923,[43] held merely that a condition subsequent certain to be performed, if ever, by the end of one life, was valid. *Smith v. Teel*, decided in 1929[44] sustained a disposition of land to testator's wife for life, with a power to consume, followed by a gift over of "whatsoever remains" to three named children. Here, again, only one life could elapse before possession would reach the ultimate takers. *In re Baxter's Estate*, decided in 1941,[45] involved a more complex disposition involving land. A trust for ten years was created under which the trustee was directed to convert. Thus it became a disposition of personalty. Also, the trustee's power to sell eliminated any otherwise caused "suspension of the power of alienation." Even if these two salvaging factors had been absent, the trust was for only ten years, which is not "too long" under even the statutory rule. A second point involving future interests rather than trust durations was also present. The ascertainment of the ultimate takers, described as "heirs" of the primary takers was valid, was postponed as to each share by only one life and hence was valid. *In re Conness' Estate*, decided in 1952,[46] had several interesting aspects, but only one of them is here relevant. A will clause directed the sale of lands located in six states, the payment of many specific legacies, and the utilization of the "excess," which proved to be $128,584, "for the education of my brothers' and sisters' children." When the will was executed all of the testator's then living nieces and nephews were thirty-eight or older and several were college graduates. Having decided that the references to "education" were not imperative, the court had to decide when the class of "brothers' and sisters' children" was to be picked. By selecting the date of the testator's death, the court simultaneously followed sound principles of law and eliminated all questions of validity under the Rule Against Perpetuities. In *Dreyer v. Lange*, decided also in 1952,[47] the court was faced by an application filed by the settlor-beneficiary of an inter vivos trust to terminate the trust. The trustee, an uncle, was opposing. It is an interesting circumstance, although not perhaps legally relevant, that during three and one-half years of the trust's operation, the trustee-uncle drained off about seven-eighths as much as the settlor-beneficiary had received. Despite a reserved power to appoint, the settlor was held to have the "reversion," and the limitation to her heirs was held nugatory, and hence she was the "sole beneficiary" and was entitled to revoke the trust. This case accepts the age-old rule of worthier title. If Arizona has an experience like New York, this case is only the

[43] 25 Ariz. 563, 220 P. 397 (1923).
[44] 35 Ariz. 274, 276 P. 850 (1929).
[45] 58 Ariz. 16, 117 P.2d 91 (1941).
[46] 73 Ariz. 216, 240 P.2d 176 (1952).
[47] 74 Ariz. 39, 243 P.2d 468 (1952).

beginning of a long line of cases turning on "remainder" or "reversion," where there is a limitation to the heirs or next of kin of a settlor of an inter vivos trust.

There are three Arizona decisions which require more detailed consideration. *Valley Nat'l. Bank v. Hartford Acc. and Indem. Co.*, was decided in 1941.[48] Governor Hunt had died December 24, 1934. His will established a trust as to liquid assets amounting to $150,000 and a home valued at $15,000. As to one-half, the trustee was directed to pay the income to a daughter, Virginia, until January 1, 1945, and at that date to pay over to Virginia the corpus of this half. Even as to the land, this postponed full possession only for a period measured possibly by less than eleven years or by one life. At all events this half was valid. As to the second half, the disposition was more troublesome. The trustee was directed to hold this second half for the benefit of the child or children of Virginia, accumulating income until twenty-one, paying income for the period from twenty-one to thirty, then delivering the corpus, *but if any die under thirty*, cross interests to the other children, and if all died before thirty, corpus to Virginia. Virginia had one son, Carlton, born in April, 1931, before Governor Hunt executed his will. She had also a daughter, Helen, born August 19, 1936, a date about twenty months after testator's death but only two and one-half months after the "trust was set up." This apparently had occurred after about eighteen months of the estate's administration. The lower court held that Carlton and Helen shared in the second half and this result was affirmed. Probably this result was sound as all of Virginia's children were certain to be in existence by the end of one life, her own. Certainly the reason that the court gave as to Helen, namely, that she had been conceived before the day the trust was set up was wholly unsound. A child conceived has always been treated as a "life in being" for purposes of measuring lives under both the common law and statutory Rules Against Perpetuities. But to be usable, the life must have been in being at the moment when the instrument creating the interest spoke. This Helen had not been. Her conception must have occurred between ten and eleven months after Governor Hunt died. Assuming that the court could lawfully have held this second half to have a group of beneficiaries enlarging with each birth of a new child of Virginia all such new memberships must cease with Virginia's death. How about the provision for cross limitations as between the children of Virginia if any child died under thirty? Any such interest would violate the common law Rule Against Perpetuities because it would involve an indestructible future interest not certain to vest within twenty-one years after Virginia's life. This

[48] 57 Ariz. 276, 113 P.2d 359 (1941).

shifting future interest would probably not violate the statutory rule forbidding only suspensions of the power of alienation because, by Virginia's death, all her children would be in being, and they, by joining, could convey complete ownership. We are not told whether the trust included a discretionary power in the trustee to sell the land. If it did not, the potential prolongation of the trust as to land beyond twenty-one years after Virginia's death would inject another basis for invalidity. As far as one can tell from the reported opinion, neither the lawyers for the parties nor the judges deciding the case saw the difficulties implicit in this will. Hence they blithely sidestepped the difficulties caused by (a) Arizona having two different rules of perpetuities, one applicable to land, the other to personalty; and (b) Arizona's lack of a remoteness ingredient in its statutory rule. These problems, although not seen in this case, lurk in the shadows of every lawyer's office, awaiting an opportunity to make a devastating pounce on some luckless victim.

In re Hayward's Estate brought the will of Theodora L. Hayward before the Supreme Court of Arizona twice.[49] In the earlier of these two cases, an uncle's will was construed to give the decedent, Theodora, an undivided half in fee simple in a piece of Arizona land. The second case is of present interest. It found that an attempted perpetual trust, not exclusively for a charitable purpose, failed, and the asset passed to the intestate takers. Interesting as this case is in evidencing Arizona's strict views on what constitutes a charity, and because of its denial of the existence of a cy-pres doctrine in this state, it has importance to the present topic because it shows that a private trust to receive and apply income "suspends the power of alienation" and must, therefore, comply with the statutory permissible period of two lives plus twenty-one years when there is no discretionary power in the trustee to sell the land in question.

Shattuck v. Shattuck, decided in 1948,[50] provides an eloquent testimonial to the value of the doctrine of res judicata to salvage past errors from later inquiries. Lemuel C. Shattuck died in 1938 leaving an estate of personalty and a will which at least arguably violated the common law Rule Again Perpetuities, since it left the persons entitled uncertain for a period of forty years from the death of the testator. A decree of distribution to the trustee was made on December 21, 1939. Noting that the Arizona statutes on probate had been borrowed from California, the court followed California precedents to the effect that a will is merged in the decree of distribution and that after such a decree

[49] 57 Ariz. 51, 110 P.2d 956 (1941); 65 Ariz. 228, 178 P.2d 547 (1947).
[50] 67 Ariz. 122, 192 P.2d 229 (1948).

no inquiry can be made into the validity of the will, otherwise than by an appeal from such decree. The court made it clear that it could not even consider an invalidity based on the Rule Against Perpetuities, saying:

> The rule is not varied by the consideration that the judgment under attack may have been rendered upon a claim *tainted with the vice of being contrary to public policy.* (Emphasis added.)

This decision makes it incumbent on all members of the bar in this state to have intimate familiarity with the state's laws on perpetuities. Unless one sees and raises promptly the invoked question, the moment of opportunity is soon gone.

It is a sound rule in Arizona and elsewhere that when a statute has been borrowed from another state, the borrowed statute is normally interpreted as it had been interpreted in the state of origin. This was stressed in the *Shattuck* case, discussed above with respect to a borrowing from California, and in *O'Malley Lumber Co. v. Martin*[51] with respect to a borrowing successively from Texas and California. It was applied in the *Lowell* case, discussed above, to the statutory Rule Against Perpetuities borrowed in 1913 by Arizona from Wisconsin. If the present statute of Arizona remains unchanged, this sound rule will require the gradual importation from Wisconsin, and from Wisconsin's legal ancestors, Michigan and New York, all of those subtleties and construction strainings which sufficed to cause all three of these states to seek relief in statutory modifications. This process has not *yet* gone far enough to reveal adequately in this state its bad conseqences, the wastage of judicial time in attempting to salvage reasonable dispositions; the expenditure of clients' money on expensive litigation; the creation of formulae of disposition to which testators and settlors must conform or fail in the accomplishment of their desires. You can still find some help in the three to two decision of *Newhall v. McGill,*[52] declaring that where two constructions are possible, one good and one invalid, courts prefer the good one. But why continue, on your books of statutes, provisions which in the longer experience of three other states have been the source of frustrations, complexities, and public expense?

The simplest solution would be an act of your legislature modelled either on the Wisconsin enactments of 1927 and 1931 or on the Michigan enactment of 1949. The Michigan statute is short:

[51] 45 Ariz. 349, 43 P.2d 200 (1935).
[52] 69 Ariz. 259, 212 P.2d 764 (1949).

> The common law rule known as the rule against perpetuities now in force in this state as to personal property shall hereafter be applicable to real property, and estates and other interests therein, whether freehold or non-freehold, legal or equitable, by way of trust or otherwise, thereby making uniform the rule as to perpetuities applicable to real and personal property.[53]

This was accompanied by a repeal of the corollary provisions with respect to estates for life.[54]

Such an enactment would free Arizona from the embarrassment of two different rules, one applicable to personalty, the other to land; would eliminate this state's mistaken following of New York in substituting two lives for multiple lives; would restore as to land dispositions the common law remoteness ingredient, now present in your law as to personalty; and would retain unchanged the freeing of most trusts' duration from compliance with the permissible period of the rule accomplished by the wise decision of your supreme court in the *Lowell* case.

The need for action exists. The trail of remedy has been blazed by other states similarly affected. The result depends on you.

DISCUSSION

Comment by William H. Messinger*

We have just been favored with a most enlightening presentation of an exceedingly difficult subject. My feelings of inadequacy in responding to the chairman's request for comments know no bounds. I recall that the great Ralph Waldo Emerson, in expressing himself on the theme that, at least, bits of wisdom may sometimes come from the lowly, said, "Perhaps the hired man may be the apostle or the evangel of wisdom." Yes, perhaps the hired man may be such, in the case of Emerson, for I believe that at one time his hired man was Henry David Thoreau.

[53] Mich. Comp. Laws § 554.51 (Mason. Supp. 1952).
[54] Mich. Comp. Laws §§ 554.14-.20, 554.23 (Mason. Supp. 1952).
* Member of the Phoenix Bar.

Mr. Powell has made a powerful appeal for Arizona to recognize its error in following the false prophets of New York, Michigan, and Wisconsin in adopting the statutory rules modifying the common law rule as to perpetuities. With much logic Mr. Powell has pointed out that those states have learned by bitter and costly experience the folly of their innovations and have abandoned them. He urges us to do likewise. The Bar and the people of Arizona generally are greatly indebted to you, Mr. Powell, for this able and timely presentation. I am sure that thoughtful consideration will be given to these recommendations. As has been pointed out, we are a young state and perpetuities problems seldom have been presented in any form to our courts. Our lawyers, too, generally speaking, are a conservative lot, disposed to lean over backwards in the drafting of documents involving perpetuities problems, endeavoring to keep their clients from becoming juridical guinea pigs in the development of the law, while perhaps satanically hoping that some other lawyer will stub his toe and start the grinding out of the determinative decisions.

I'm sure that most lawyers everywhere have a feeling of anxiety when faced with problems of perpetuities, and the problems, as we all know, arise constantly. These problems are bad enough, as Mr. Powell has pointed out, under the common law Rule Against Perpetuities and its corollary rule against restraints on alienation which apply to real and personal property alike. They are doubly bad under the statutory rules which frequently do not apply both to real and personal property and often intermingle or mold into one, and sometimes confuse, the common law rule requiring vesting, that is, commencing within a prescribed time, and the corollary rule inhibiting the lack of a power of alienation beyond permitted time. Arizona is one of those states which has practically resolved the two common law concepts, "inhibition of remoteness of vesting" and "restraints on alienation," into one by its statute relative to restraints on alienation.

As Mr. Powell has emphasized, we have few guideposts in the way of judicial decisions in Arizona. Our leading case, as he has mentioned, is *Lowell v. Lowell*, and then we have, of course, *In re Hayward's Estate*, and *Shattuck v. Shattuck*. Those, I believe, are our most important decisions. All have been discussed by Mr. Powell, so I shall take very little time on them. The *Lowell* case is quite commonly cited as authority that Arizona follows generally the common law of perpetuities as to personal property. Yet all that our court really decided in that regard was that Arizona follows the common law to the extent that we permit personalty to be held in perpetuity for a charitable use. *In re Hayward's Estate* throws little light on our law. In that case the final statement in Thompson's will was, "It is my wish, though this is not a restriction

or limitation upon the use and enjoyment of the legacies and bequests herein made, that my estate . . . shall be kept among the descendants of my late father and mother." This was held to be but the expression of a wish. However, our court *said* that if it constituted a disposition of his estate it would violate our statute, as it would restrain the alienability of property through future generations ad infinitum.

In *Shattuck v. Shattuck*, the will set up a trust for a term of forty years, beginning with the death of the testator. It was claimed that this provision continuing the trust for forty years violated our statute. The court, as Mr. Powell has stated, applying the rule of res adjudicata, gave effect to the decree of distribution, so we don't have any decision further on our point. But the court did say, "Very interesting questions as to whether or not the rule against perpetuities applies to personalty, and whether the facts of this trust bring it within the proscription of the rule, and others, are learnedly and exhaustively discussed in the briefs. We find it unnecessary to discuss them, for if the rule of res judicata applies and the decision of the learned trial judge dismissing the action was correct, there is an end to the matter." The court then, of course, did find that the rule applied. An examination of the supreme court briefs in the *Shattuck* case discloses that counsel strenuously maintained that Arizona has not definitely committed itself to the position that the common law rule of perpetuities applies as to personalty generally and that in fact we have no perpetuities rule at all as to personalty. The language of our court in this case certainly throws doubt on the broad construction often placed on the earlier *Lowell* case. Also, this case should serve as a warning against basing a term on years instead of life. Where years are used as a base, the term, of course, should never exceed twenty-one years.

Mr. Powell has discussed the saving grace which a power to sell, given to a trustee, may have to prevent a trust from otherwise being held invalid. Most careful Arizona lawyers probably include a broad power of sale and in many instances make it a direction, depending thereby upon the equitable conversion theory, or hoping that our statute will be held, as its wording may imply, simply a rule on restraints on alienation and not a rule against remoteness in vesting. Many Arizona lawyers also make it a practice to include another saving clause spelling out expressly that, anything appearing to the contrary notwithstanding, there shall be vesting not later than twenty-one years after the death of the survivor of the two named or designated persons in being. If the client is unwilling to be so limited, perhaps we may do as Mr. Bowe suggested this morning—cause the perpetuities rule of a more favorable state to be made applicable. An illustration which Mr. Bowe also used is the setting up of an inter vivos trust in such more favorable state.

Mr. Powell also has mentioned the matter of partial invalidity, and that is a troublesome problem. He has pointed out some of the disastrous situations wherein the whole estate program or plan failed because of partial invalidity. Section 402 of the *Restatement of the Law of Property*, of which Mr. Powell, as you know, was the Reporter for so many, many years, in substance lays down the rule that when part of an attempted disposition fails, as a direct consequence of the Rule Against Perpetuities, the effect, if any, of this partial invalidity upon the balance of the attempted disposition is determined by judicially ascertaining the desire of the conveyor or testator if he had known of this partial invalidity. Our Arizona courts are disposed to follow the *Restatement*, so it is suggested that it may be advisable on occasion to use in wills a paragraph something like this: "If any part of this will, or of the trust created, should be invalid, illegal, or inoperative for any reason, it is my intention that remaining parts so far as possible and reasonable shall be effective and fully operative. My executors and my trustees, or any of them, may seek and obtain court instructions for the purpose of carrying out as nearly as may be possible the intention of this will, as shown by the terms thereof, including any terms held invalid, illegal, or inoperative."

It seems to me that the great hardships in applying the Rule Against Perpetuities have come often from the fact that the rule is violated if by any possibility a situation *might* arise wherein vesting would not take place within the permitted period; and in determining that a situation might arise, courts sometimes have based their determination more on historical, archaic, syllogistic, or fallacious, rather than realistic, reasoning. For example, the determination may be based upon a possibility that a woman might give birth to offspring, regardless of how old she is. In Massachusetts in 1954 there was enacted, I believe, a statute sometimes referred to as the "wait and see" statute, permitting a wait and see principle in certain cases involving the Rule Against Perpetuities. Maine and Connecticut have somewhat similar statutes. Pennsylvania has a so-called "second look" statute under which I understand the validity of all interests is determined on the basis of "actual rather than possible events." I am sure that we all will agree that no paper is properly drafted on the basis that we will wait and see if it proves to be valid. Yet it would seem that such statutes might save many dispositions which otherwise would be found invalid. If time permits, I believe we would profit greatly, Mr. Powell, if you would tell us briefly how those statutes are working out and whether we should consider adoption of such or a similar statute in Arizona.

We have also another closely related future interest statute concerning which I would like to question Professor Powell. It is Section 33-238, Arizona Revised Statutes, and it pertains to the accumulation of rents

and profits from lands. It is my understanding that under the common law rule against accumulations, income may be accumulated and added to principal for a time not exceeding the period of the Rule Against Perpetuities. It is my understanding further that in 1830 New York adopted a statutory rule against accumulations, that thereafter Michigan adopted a similar act, which later was followed by Wisconsin, and that we have based our own present section 33-238 upon the Wisconsin act. In fact, the history of the adoption of the statutory rule against accumulations seems to have paralleled in practically identical fashion the adoption of the statutory Rule Against Perpetuities, and like the latter, it appears to be more restrictive than the common law rule and to be very difficult to understand and apply. I'm sure it would be exceedingly helpful to our Bar, Mr. Powell, if you would tell us what you think we should do with respect to our statute on accumulations and with respect to the so-called "second look" principle in connection with a statutory Rule Against Perpetuities.

Mr. Powell: The courts find no difficulty in facing and resolving the question as to the possibility of further issue when, for tax purposes, they have to value a remainder given to charity. It's a litigable question on which evidence can be received as elsewhere. We need a statute on that. You need a statute also that will take care of the possibility that I, for instance, will in the future marry a person not yet born a year ago; actually that's a continuation of the common law concept that any possibility of violation destroys the gift. The "wait and see" statute does care for these two things, but does much more. It makes it remain uncertain, oftentimes for the period of thirty to forty years, as to who is going to be entitled to the property of the claim. Consequently it makes it extremely difficult to deal with the title of land or to deal with the title as security. I think the "wait and see" statutes accomplish more harm than they do good, although they do good—no question about it. There's an extremely good discussion of that, also, in the Niles article in the February 1959 issue of *Trusts and Estates* magazine.[1]

Coming to the accumulations question, Mr. Messenger is, of course, right that the accumulations statute of Arizona has had exactly the same history as I traced on perpetuities. It's a statute that has bad results in two ways, and I'm speaking now from the New York experience with it. In the first place, it is frequently unwise to dump a chunk of accumulated money into the hands of a person at twenty-one. Apart from the question of tax-savings and other things of that sort, that is socially an undesirable

[1] Niles, *Two Lines Down—and Goal to Go: Change in New York Perpetuities Rule Appraised—Further Reform Suggested*, 98 Trusts & Estates 104 (1959).

thing to compel, as your statute and ours both do. In the second place, as Mr. Bowe pointed out this morning, one of the great ways of saving taxes is by an accumulation trust which causes the accumulated income to be taxed to the new and separate tax entity, the trust. In common law jurisdictions, like his state of Colorado, that can be done for the life of the settlor. In your state and ours it can be done only for the benefit of a minor and only when the minor gets the property. It severely lessens the utility of the accumulation device for the purpose of tax saving under the income tax. The result is that in New York there is now pending in the legislature this year a statute recommended by the Association of the Bar of the City of New York, backed by a very large number of other groups, that would substantially lessen the rigidity of our rule.[2] I think you would do well to do likewise.

Comment by James Powers*

First, let me join with Mr. Messenger in expressing my appreciation and admiration to Mr. Powell for a most enlightening address. Like most lawyers, I've had a nodding acquaintance with our statutory rule on perpetuities, but it was not until today that I felt myself reasonably well educated, as the result of listening to Mr. Powell. My only regret is that he proposes to deprive me of any benefit from that new-found learning by having all those statutes repealed.

I have two thoughts on which I think we all might be interested in having Mr. Powell's observations. As he rightly pointed out, we have not had a large number of wealthy decedents in Arizona and, as a consequence perhaps, the interest in the Rule Against Perpetuities is not as great as it might otherwise have been. We do have, however, our share, I think, of other kinds of trusts. I'm thinking in particular of profit-sharing plans—trusts that are set up in connection with profit-sharing plans. As I understand it, there are a number of states which have statutes exempting trusts set up as a part of a profit-sharing or retirement plan from the Rule Against Perpetuities. I wonder if perhaps Mr. Powell might comment on that. Is such a statute necessary? Does it do any good? Is the ordinary employees' profit-sharing trust subject to the Rule Against Perpetuities in the absence of such legislation?

[2] This statute was enacted in 1959. N.Y. Sess. Laws 1959, c. 452, amends Real Property Law §§ 43, 45, and 46, to eliminate limitations of successive life estates to two and permit any favorable number of lives in being, to conform to the new Rule Against Perpetuities adopted in 1958. See Lacovara, *State Legislation Affecting Trusts and Estates*, SECTION OF REAL PROPERTY, PROBATE AND TRUST LAW, PROBATE AND TRUST LAW DIVISION, PART I, 1959 A.B.A. PROC. 159.

* Member of the Phoenix Bar.

Secondly, I would like to have Mr. Powell's observations on the Rule Against Perpetuities in relation to its application to a trust of land where the trustee is given a power of sale. As I understand Mr. Powell, that does not constitute equitable conversion, so that you don't treat it as personalty. If it's still realty and our statutory rule doesn't apply, what rule does, if any?

MR. POWELL: The first is a very easy question. Pension plans in many instances do provide for interests that would be beneficial to persons not necessarily born when the plan was set up. I think, therefore, there is little question that there are risks in pension plans of that character under the Rule Against Perpetuities, and under the rule against accumulations, unless you have an exempting statute. I think the general practice throughout the country, in the states that have become acquainted with the necessities of pension plans, is to pass such a statute. I think it would be a desirable one for you.

Now on your second question of the rule applicable to a trust of land where there is a discretionary power to sell and where, therefore, there is no suspension of the power of alienation and where, therefore, there is no applicability of the statutory rule, my answer to that would be that there is no regulation applicable to trust duration. This is the situation which exists in two-thirds of the United States and has existed in two-thirds of the United States for a century without harm. There is a practical restriction. The Rule Against Perpetuities, even if it does not apply to trust duration, does apply to the successive interests in the beneficial rights under the trust and to the future interests created to take effect after the trust. By virtue of the invalidation of such future interests and the complementary principle that a trust lasts no longer than it serves the purpose of the limitation, you have a practical limit on the duration of trusts which has served adequately at common law to restrict the duration of trusts within decent limits.

Comment by Ozell M. Trask*

Mr. Powers was just lamenting the fact that under the recommendation of Mr. Powell the legislature would repeal all the knowledge and learning that he had been able to accumulate by following the statutory rule which we have in Arizona; now I'm commencing to lament the fact that, if that's repealed, I'll have to go back and try to remember what I didn't learn in the course in future interests which I took, and I think I will be in worse shape than Mr. Powers with his problem. I would like to pose questions, likewise, to Mr. Powell, rather than comments.

Mr. Powell, I did enjoy your presentation very much. I noticed that in your outline of the Arizona decisions on the Rule Against Perpetu-

* Member of the Phoenix Bar.

ities which, you pointed out, came from following similar decisions in two other states—I believe you said Minnesota and one other—that where a trust is established and the power is given to the trustee to sell, there is no violation of the Rule Against Perpetuities. In answer to the question which Mr. Powers just asked you, you commented on that very problem to a certain extent, pointing out that there are practical limitations on the duration of a trust which in themselves take care of the Rule Against Perpetuities. I would like to ask the question as to whether or not this existence of the power of sale which renders inapplicable the Rule Against Perpetuities was a matter of public policy; and whether, assuming the policy of the Rule Against Perpetuities is good, in order to avoid alienability, is this trust power which defeats that restraint, also good? You have in some sense commented on that already. I would also have some fear of statutory change of this trust power and would like to ask you if my fear is justified in a state like Arizona where people who are interested in estate planning have relied upon the *Lowell v. Lowell* decision, and the decisions of our supreme court, and our general understanding that a power of sale in a trust will prevent the trust from being subject to the Rule Against Perpetuities. In any modification of the Rule Against Perpetuities by eliminating it by statute, shouldn't there be some statutory retention of that principle where trusts have been created in reliance upon it?

Secondly, I believe you commented in your presentation that there is some doubt in your mind as to whether or not the state of Arizona is committed to the cy-pres rule, perhaps just with respect to charitable trusts, but I understand that in some of the legislation that has been proposed modifying the Rule Against Perpetuities it has been recommended that the cy-pres rule, or some modification thereof, be adopted so that it could be a statutory saving clause. Perhaps the "wait and see" principle is some answer to that. But I would think that a statutory cy-pres rule would be good, and I would like to have your comment on it.

Finally, I wonder if there is not a model perpetuities act. I understand that there is such an act proposed by the commissioners on uniform state laws. I know very little about it, but I would like to have your comment on the advisability of enacting a substitute piece of legislation which would solve the perpetuities question, rather than just eliminate the statutory rule which we now have and take it back to the common law rule which, for me at least, poses problems of some magnitude.

MR. POWELL: First of all, on the policy question. If the policy of the Rule Against Perpetuities is to safeguard the alienability of specific properties, a power of sale in the trustee completely safeguards that. There is no inalienability of any single asset where such a power of

sale exists. Now if you are suggesting that perhaps society needs protection against the pocketing of wealth for the accomplishment of stated objects, that's a policy other than the Rule Against Perpetuities. It might be socially desirable, but it's not the rule against perpetuity policy. So I would say that insofar as there is present a discretionary power of sale, the reason underlying the historical, century-old policy of the Rule Against Perpetuities is safeguarded fully.

Now for your second question, do we need to save this significance of the *Lowell* case on the discretionay power of sale, in any new legislation? I say, "No." There was no regulation of the duration of trusts at common law. If you repeal the statute that you have, there would be none. There would, therefore, be nothing to save it from, and you wouldn't need an explicit saving of the significance of the discretionary power because that would be the law anyhow.

Now as for the cy-pres doctrine which Mr. Trask mentioned a moment ago, he is using the phrase in the fashion in which it has been used some places in the country in connection with noncharitable gifts. The doctrine of cy-pres primarily and normally is confined to the doctrine of charitable gifts, but what Mr. Trask means is the kind of thing that Wisconsin and Massachusetts have done, providing that if in the limitations there is a requirement that people attain thirty or forty or some other age, it shall be sustained as if the maker of the requirement had said twenty-one, and in that sense I think it a good rule. In other words cut down the long term tie-up that the chap has made, without invalidating his whole disposition. Now if you want to call that cy-pres, fine. I'm for cy-pres so defined. The model perpetuities act was something that I had something to do with in the days of the *Restatement*. We got terribly involved in drawing it up. Lewis Simes of Michigan did the major part of the work on it. It's never been adopted anywhere and I'm just as happy it hasn't.

Comment by Gerald Jones*

I join with others in thanking the University for making this conference possible and for having Professors Thurman, Bowe, and Powell give their carefully prepared and helpful papers.

Even if nothing can be done toward the legislative action suggested by Mr. Powell in his paper on perpetuities, he has recalled to our attention two noteworthy particulars important in the application of our laws affecting perpetuities and alienations as they now stand, *viz.*, that section 33-235 and allied ones do not apply to personal property and that the common law Rule Against Perpetuities in Arizona governs only dispositions of personal property (excepting estates for years),

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and also that if the disposition is in trust and the trustee has the power of sale of all property, then the common law rule applies to the real estate on the theory of a kind of equitable conversion.

But Mr. Powell has done far more—he has awakened us to perpetuities and restraints on alienation problems presented by our statutes which he believes should be corrected by legislation. Personally, I agree with him almost completely and trust the Bar does not let his effort die a-borning.

It seems we are behind the times and that we are retaining the two rules, one affecting real estate (statutory) and the other personalty (common law), when the states which created the distinction between the two classes of property have abandoned it as highly undesirable and have returned, either completely or very largely so, to the common law for disposition of real or personal property. Even as written and undisturbed, there are inconsistencies in the statutes, as well as provisions useless if innocuous, that ought in any event to be removed.

Personally, I favor the elimination of any distinction at all based on the nature of the property disposed and that the common law rule as created and developed by the courts over many decades should, in the main, be applied. In any event, Arizona courts should not be in the position of having to resort for interpretative aid to decisions in New York, Michigan, and Wisconsin (as is now the case, I am sure any Arizona lawyer who has studied the problem will agree) based on statutes found unworkable and actually repealed in each of those states.

I am reluctant to go quite as far as Mr. Powell in the period of suspension of vesting. It does seem to me that a vesting deferred longer than two, maybe three, lives in being when the interest is created and twenty-one years thereafter is unreasonably long—else we may find ourselves tied to the *Thellusson* rule, nowhere considered desirable.

Any Arizona lawyer who pretends to draw instruments with future vestings will, I believe, find profit in reading Mr. Powell's excellent paper. He will find there, and I do not know of any other place, a thorough and penetrating discussion of all the Arizona cases which touch even remotely on this difficult subject of perpetuities—one which has laid low many a will and inter vivos trust and defeated the grantor's purpose.

Federal Estate and Gift Taxation of Community Property

SAMUEL D. THURMAN, Jr.*

The subject of my address, "Federal Estate and Gift Taxation of Community Property," encompasses three rapidly expanding fields: community property, life insurance and, needless to say, federal taxation. You in Arizona do not have to be reminded that each year finds a higher percentage of Americans living here and in the other community property states. Let's start with Louisiana to the east; go to Texas, New Mexico, Arizona, California; skip Oregon (Oregon had a community property system for a very brief period, abandoning it when, as in a number of other states, it was no longer felt to be advantageous taxwise); go on to Washington; and then down to Idaho and Nevada. The whole southwestern part of the United States is experiencing a mass movement of population in its direction. I think that your Governor, in his noon address, was unduly conservative in his projected population figures. In a recent magazine article some population estimates for 1970 were a 57% increase for California, 65% for Florida, and 79%, the highest percentage of all, for Arizona. By a rough calculation I conclude that you will have a population of two million by 1970.

The figures on the growth of life insurance in recent years are equally impressive. As of a year ago, it was estimated that there were over one hundred million life insurance policy holders, a quarter of a billion policies, and over 500 billion dollars in insurance protection. That amounts to an average of almost $10,000 per family throughout the country. The figure of 500 billion dollars is well over the national debt, and well over our gross national product each year. Should Congress want to pay off the national debt, all it would have to do is levy a 100% tax on the face value of all life insurance policies, and the debt would be paid off. The recent growth in life insurance is impressive when compared with figures before the war. For example, ten billion dollars of life insurance was sold in 1940 and sixty-five billion was sold last year. It is obvious that when we combine these two areas of growth, the rapidly increasing population of the community property states

* See Contributors' Section, p. 284, for biographical data.

and the growth of life insurance, we discover that community property life insurance has become a highly significant type of property in this country.

We are all familiar with the growth of the third component of today's talk, federal taxation, so I will not dwell on that. Suffice it to say that when federal tax problems are superimposed on community property life insurance, the amalgamation is truly big business and, moreover, complicated business.

Before one can answer the many tax questions that arise with reference to community property, and especially community property life insurance, one must understand the nature of the particular property involved. This requires a reference to the laws of whichever community property state is involved. There are eight such states, and their laws do vary to some extent. The United States Supreme Court has made it clear that state property concepts are by and large controlling even when we are dealing with federal tax questions. This was not true in the period from 1942 to 1948 when Congress tried to ignore community property law, but we have now gone back to the earlier rule.

There is one point that I want to make clear at this time, and that is that I am no authority on Arizona community property law. I have made an effort to study Arizona statutes and decisions, but if I err in my reading of your laws, I hope you will correct me. There have been several instances where I have been unable to find answers in your decisions and statutes, so I have looked into the decisions of neighboring states, particularly those of Texas and California. We seem to be a bit more litigious, although I suppose the more likely answer is that Arizona attorneys are more competent and more careful, and consequently their work breeds fewer lawsuits.

My talk is to be divided roughly between (1) problems arising when the husband is the first to die, which, as you may know, is the more likely situation, and (2) problems that suggest themselves when the wife dies first. In both cases I will assume that the husband was the acquiring spouse, since in all likelihood the community property came from his earnings. My remarks are for the most part going to be addressed to the wife's half of this community property, whether the husband predeceases her or whether she dies first, in contrast to Mr. Bowe's discussion this morning when he was dealing with the residuary trust that the husband might set up consisting of his half of the community property.

Prior Death of the Husband

The first situation, then, is when the husband dies before the wife. Let us examine the property law, without getting involved in tax problems just yet, and inquire how much protection is afforded

the wife when the husband predeceases her. I might interject a few remarks at this point with reference to separate property in Arizona and in California where I think we have been derelict in the protection of wives. Individuals who come to us from non-community property jurisdictions may bring with them substantial amounts of property acquired over a period of a life time, and whether it is property that stemmed from the husband's earnings or whether it was inherited, Arizona gives no protection to the widow with respect to the property owned by the husband at his death.

This is not entirely true in California. We have a statute which originally provided that when property was brought into the state from a non-community property jurisdiction it would become community property if it would have been community property had the spouses been living in California when it was acquired—in other words, if it stemmed from earnings. However, this was declared unconstitutional by the California Supreme Court, which reasoned that you couldn't take the husband's property and convert it into half the husband's and half the wife's; the statute was later changed, in large part by interpretation, to a statute of succession. The California Law Revision Commission revised this statute rather substantially two years ago to provide that when the husband's property, stemming from earnings, is brought into the state, it is not community property, but if the husband dies first, at least one-half of it will go to the wife; he does not have a power of testamentary disposition over more than half. Where the wife dies first, she now has no power of testamentary disposition over any part of her husband's property; it is still separate property. I think that there is a fair probability that before this change was made, the law which gave the wife a power of testamentary disposition over such property might have surprised her husband who thought the property was all his. There is a good chance that this might have been declared unconstitutional, but under our new law the wife has no power of testamentary disposition over this type of property. However, she is protected if the husband dies first.

As to other types of property that the husband might have, for example, property acquired by inheritance, the wife will have no protection. If he inherited the property before coming to California, she gave up all rights in that property by way of dower and statutory substitutes when she left the separate property state. Consequently, if the wife wants to get protection in that kind of property in our state, and I assume in Arizona as well, she had better divorce the husband rather than wait until he dies, because she can get substantial alimony rights that may well be a charge against his separate property. It seems to me that with the increasing number of individuals coming

to our community property states where the wife does not have any protection in a great deal of the property, something might well be done about that in the future. The non-community property states by and large do not distinguish between inherited and earned property owned by the husband during his lifetime. Especially in the case of real estate, the wife would have her dower rights in either case.

Let's get back to the question of community property when the husband dies first. All of the community property states preclude the husband from making a testamentary gift of more than one-half to someone other than the wife. This is just elementary law, and it makes no difference whether it is personal or real property. It is interesting to observe that today, by and large, personal property is far more significant than real property in the average estate, and very frequently this personal property takes the form of life insurance. I would like to emphasize that this fact of the husband's inability to make a testamentary disposition of more than one-half is very significant in what I will have to say in the remainder of this discussion. This limitation not merely applies to outright gifts to third persons, but it also precludes the husband from leaving the wife's half to her in trust; that is, a life estate to her and remainder to the children. He cannot give away that remainder interest in his wife's property by testamentary disposition without her consent. Yet this is precisely the result that many husbands desire, and if there is any central focus in the present discussion, it is this particular device of leaving a life estate to the wife and remainder interest to the children. This was the type of thing that Mr. Bowe spoke about this morning with reference to the husband's half, which is a device the husband can use for *his* half, of course, and then at the death of the wife you avoid the tax on his half of the property. But as to *her* half he cannot dispose of it by his testamentary disposition—the wife can say, "I will not accept that; I will take the property outright."

Why do husbands so frequently desire to make that type of disposition? This preference goes back to a much earlier time than the period when the federal estate tax was adopted. Husbands are perfectly willing to leave their wife the entire income from all the community property plus various powers of invasion, but are frequently reluctant to have any of the property go outright. The reasons for this I suppose are obvious: the fear that the wife's lack of business experience, or presumed lack of such experience, will result in mismanagement and loss of property; the fear that she will be importuned by relatives and others if she has unfettered control over the property; and no doubt the concern of some that a second husband may come

along and take over the property the first husband spent a life time acquiring. Whether there are, in addition, tax advantages, is something I will discuss shortly.

Lifetime Dispositions

Let us now suppose that the husband, instead of waiting until death to leave the property in the probate estate, makes a lifetime disposition of the community property. What are the wife's rights? How much protection does she really have? As to real property, she has good protection in both community property and non-community property states. She has to join in the deed. But as to personal property, and the average estate today consists primarily of this type of property, there is much greater variation. Let us consider on the one hand Texas, Louisiana, and Arizona. Your statute provides that the husband can by an inter vivos disposition dispose of the community personal property; he is the manager of the community property. There is no question but that he is the manager with reference to any business transactions; but even beyond that, he can give the property away just so it is not, according to the language of the Arizona Supreme Court, "in fraud of the wife."

Just how much protection does Arizona law give the wife? If the husband gives everything away, I suppose you can make out a pretty good case of fraud. But suppose he stops short of that and gives substantial amounts away. There are a number of dispositions that closely approach a testamentary disposition. The husband, for example, makes an out-and-out gift to a third person the day before he dies. This is a lifetime disposition; presumably it is not governed by the strict half-and-half rule of testamentary disposition. Suppose he sets up an inter vivos revocable trust, or buys life insurance and retains the right to change beneficiaries. In any of these cases he may be giving a life estate to the wife. He may give her a life estate in the insurance proceeds by setting it up in trust, or by one of the installment options; in the inter vivos revocable trust he may reserve a life estate in the wife. In any event he is doing something that he could not do by a testamentary disposition short of getting his wife's consent.

Then will these lifetime transfers in Arizona be set aside because they are in fraud of the wife? There are a few guideposts. The Arizona court has said that you should look to the amount that he gives away compared with the amount that is left to her, as a rough measure of whether the gifts are in fraud of the wife. You are to ask: Was this a reasonable disposition? I am puzzled, however, as to how to apply this test in the case of insurance. Do we in that case look to the amount of insurance premiums, which may be $20,000, and compare it with the property that is left, which may be $20,000;

or do we look to the proceeds which may be $200,000, and compare that with the property left, $20,000, in a case where the husband is making the insurance payable to a third person? I don't know what the answer to this would be in Arizona. The cases do indicate that if the insurance that he takes out is payable entirely to his own estate, that will be in fraud of the wife; but where it is payable to a third person, the results are rather inconclusive.

In Arizona it seems clear that the husband may, by means of an inter vivos revocable trust or by means of life insurance, even though he retains all the powers of ownership prior to death, set up a life estate for the wife, remainder to the children. It would be difficult, if not impossible, to show that this was in fraud of the wife, since he has taken care of her by means of the life estate. It is not like an outright gift to a third person of all community property. I question, however, whether the courts have reached the right conclusion when they treat insurance and revocable inter vivos trusts as lifetime dispositions, where the husband's only limitation is that he cannot defraud the wife, rather than as testamentary dispositions, where the limitation is a flat power to dispose of only one-half. Again bear in mind that this problem looms larger and larger where insurance is a major asset, as it is in most estates today.

Let me compare the situation in California. There the wife really gets greater protection during her lifetime than she does at death. By California statute any gift of community personal property by the husband without the wife's written consent is completely voidable, 100%, at the wife's election, but not the husband's, unless it is a business transaction; the husband is still the manager of the community so far as a business transaction is concerned.[1] However, the California courts have said that if the wife does not elect to call back the gift, does not elect to void it before the husband's death, then she can claim only half the property. In other words the courts treat it somewhat as an advance testamentary disposition inasmuch as the husband could dispose of half at death.

Wife's Interest In Insurance Proceeds

Very significantly, and quite appropriately in line with the above statute, California has held for some years that in the case of life insurance where the husband names some third person as beneficiary, the wife can claim half the proceeds. That comes as a great shock to many husbands who had not been aware of this right of the wife in California. It comes as an even greater shock to many life insurance salesmen and life insurance companies when they discover that the

[1] See Thurman, *Federal Estate and Gift Taxation of Community Property Life Insurance*, 9 Stan. L. Rev. 239, 246-49 (1957).

husband, who presumably is paying for an insurance policy, does not have complete control over the policy where it is a community policy and the premiums are being paid from community property. He does not have complete control, and at his death, no matter who the beneficiary is, the wife is co-owner, not merely of the premiums which were paid, but also of the proceeds. So in California we have a consistent scheme. Whether by way of testamentary gift, by way of insurance, or by way of inter vivos revocable trust, the wife can always claim her one-half and the husband can in no case compel her to take a life estate, with remainder to the children, in her one-half of the community property.

The Texas rule, and presumably the rule in Arizona, puts a premium upon the husband's taking some kind of action during his lifetime if he wants to reduce somewhat the claim of the wife as to her half of the community. I might point out that a third type of community property treatment, that found in Washington, goes even farther than in California. There the wife can claim 100% of the proceeds of a community property life insurance policy after the death of the husband. That seems a bit anomalous. Although your court has said from time to time that Arizona law is somewhat like that of Washington, it clearly is not in this respect.

Community Property v. Separate Property

So much by way of the property background. We turn next to the tax consequences of these rules that I have briefly summarized. Still assuming the prior death of the husband, the first question must be: Are we dealing with separate property, or are we dealing with community property? A leading case in this area is *Greenwood v. Commissioner*,[2] which went up to the Ninth Circuit from Arizona. Here the sole question was whether the husband had transmuted his separate property, earned in another jurisdiction—New York, I believe—into community property. If not, it was all to be included in his gross estate; if it had been transmuted, only half would be included. This estate consisted mainly of securities and cash which the husband had inherited, the couple later moving to Arizona. He leased a joint deposit box and set up a joint bank account, but the securities were in his own name. The husband managed everything, buying and selling without consulting his wife beforehand. From time to time the couple would refer to this property as half the husband's and half the wife's. They even made the remark, "Well, we have a lot of community property," probably with about as much understanding as many individuals have when they use the term "community property."

[2] 134 F.2d 915 (9th Cir. 1943).

The Ninth Circuit agreed that the law of Arizona would govern. If the property was community property under Arizona law, then only one-half would be taxed. The taxpayer argued that you can transmute personal property informally in Arizona, and the court agreed, citing the case of *Rundle v. Winters*,[3] an Arizona case where the Arizona Supreme Court said that whether personal property is community property depends on the intent of the parties. You don't necessarily have to have formalities in the transfer. However, the federal court said that the personal property must be *treated* as community property by the parties—mere intent is not enough—and we have very few Arizona decisions telling us just exactly what that means. Washington cases have said that an oral agreement is not enough. In California it is sufficient if the property is treated as community property, but California is unbelievably liberal—far too liberal, in my opinion—so far as any practicable workable rule is concerned. For instance, every morning over the breakfast table you can convert your property from community to separate, or vice versa. You can also convert real property, that is, ignore completely the statute of frauds. Whether it is community or separate property apparently depends upon what its status was on the day of the husband's death.

The court, in *Greenwood v. Commissioner*, held for the Commissioner, pointing out that the box rental agreement seemed to indicate that the property was separate. The court did not think that the signature card for the joint bank account, and such statements as "It is half yours," necessarily indicated that the property was community property. The taxpayer had made the argument that it is doubtful whether you can have joint tenancy in personal property in Arizona. The federal court disagreed and said that under the Arizona cases you can have joint tenancy in personal property. So the conclusion was that this was separate property and therefore all includible in the husband's estate.

It thus becomes very important to decide in the first place whether we are dealing with separate property or with community property. I am not going into the various presumptions in this field since most of you are well familiar with them. But if we find that we are dealing with Arizona community property, then it is quite clear that only half will be taxed in the husband's estate when he dies. You don't have any complications, such as a distinction between property that was acquired before July 29, 1927, and property that was acquired after that date. We in California do, and in our state it is only the post-1927 community property that is taxed as community property.

[3] 38 Ariz. 239, 289 Pac. 929 (1931).

With respect to separate property it is frequently advisable to have a husband and wife enter into a formal written agreement whereby they transmute it into community property, especially if it is low basis, high value separate property. There are many instances in which it is desirable to do that. There may be a gift tax involved, although it is frequently done informally with no thought given to the gift tax consequences, which may not come up for many years, if ever.

Shares of corporation stock are an illustration of property which the husband and wife may find highly desirable to transmute into community property by formal written agreement. It is impossible to buy shares of stock in General Electric or any other concern that I know of and have them registered in this manner: "Mary Doe and John Doe, as tenants in community property." A transfer agent of a corporation will look askance at any such suggestion, so you have to register them in the names of individuals or, as most brokers do, in joint tenancy with right of survivorship. To the broker, that is the answer to everything and he gives little thought to the tax consequences. It is especially important in a community property state to make sure that the community property owned by the spouses is not converted to separate property via the joint tenancy, right of survivorship, route. I have suggested that it is a good idea in many cases to take separate property, admittedly separate, and convert it to community; but it is even more important to make sure that property that is already community—earnings of the husband and wife—is not converted into separate property by putting it into joint tenancy with right of survivorship. California again has a rather liberal rule which will allow the parties to come forward later and say that they did not understand that this was to be joint tenancy and that they still considered the property as community. This is the famous *Tomaier* doctrine from *Tomaier v. Tomaier*.[4] As you might imagine, the internal revenue agents aren't too happy with a rule of that kind, and they will fight it out in the courts if you come forward with an alleged oral understanding that the parties intended the property to remain community. I think, therefore, that it is highly desirable to have the written agreement.

Let me now point to the disadvantages in commuting community property to separate property, primarily joint tenancy. In the first place, you know that the surviving wife has the burden of proof as to her contribution, and even though it was half from the husband and half from the wife because it was community property, she may not be able to prove that, and therefore the law reads that it shall all be included in the husband's gross estate.

[4] 23 Cal. App. 2d 754, 146 P.2d 905 (1944).

Disadvantage number two is that estate planning is made much more difficult. The wife now takes the property outright, inasmuch as she takes it as a survivor. This property will bypass any will, there being nothing for the will to "bite on," and there is no widow's election possibility, a point I want to discuss shortly. Also, there may well be a greater tax at the wife's death because there will be more in her estate. Any incidental probate savings at the husband's death (this is frequently the objective of individuals who want property put in joint tenancy) may be far outweighed by these disadvantages.

In the third place if the wife does succeed in proving that this was community property originally, even though it is now joint tenancy, and that each therefore contributed half, so that only half will be includible in the husband's gross estate, there will be no "stepped up" income tax basis as to the one-half that is not included. The treatment is different from that accorded community property, and this becomes a major consideration today with inflated property the general rule in most estates. If you leave it as community property, only one-half will be included in the gross estate for estate tax purposes, but both halves will get a "stepped up" basis as of the date of death, or other applicable valuation date, for income tax purposes. On the other hand, if you have changed to joint tenancy, one-half will be includible in the gross estate if the wife proves that she contributed half, but only that half will get the "stepped up" basis for income tax purposes.

Estate Tax Upon the Death of the Husband

Now let us assume that you have succeeded in proving that the property in the estate is community property—there is no longer any problem of its being separate or community. Only one-half will be taxable in the husband's estate. It makes no difference under federal law whether he left it in the form of life insurance, a revocable trust, outright to the wife, or in trust to her. Under most state inheritance tax laws the relationship of the beneficiary makes a difference. As you know, that is not true with reference to the federal estate tax, with one exception, and that is in the case of a testamentary gift to a charity. There, of course, it does make a difference. Also, in non-community property states, in the case of the marital deduction, you do look to the identity of the donee. But for the most part, we don't care to whom it is left. It is included in the gross estate and is taxed accordingly. If it is community property, it is only half-taxed.

Compare the situation in non-community property states. Reference was made this morning to the problems of obtaining the marital deduction. That will depend upon leaving one-half, at least, in a particular fashion. You may not leave all of your property, life estate

to the wife, remainder to the children, and obtain the marital deduction unless you put in a taxable power of appointment. The general rule is that you must leave the property in such fashion that it will be taxable in the wife's estate.

Now must this result follow in a community property state? I think that at first blush the conclusion is yes. But let us examine that. Suppose that the entire property is left outright to the wife and there is no attempt to have her put it in trust or anything of that nature. She takes her half outright, and there is no insurance and no trust. She may do this in all community property states when the disposition is testamentary—and we shall assume that—and when there is no question of insurance or lifetime gift. If her half isn't spent by the time she dies, it is going to be taxed at her later death. Of course, whatever she does with her half has no bearing on the tax on the husband's half at his death; his half is taxable at that time. This, then, is the situation when the husband leaves all the community property to his wife, both his half and hers. There is a tax on one-half of the community when the husband dies and a later tax on the entire value of the community, whatever is left, when the wife dies.

But let us suppose that the husband does not leave a simple will leaving everything to the wife, or leaving her at least her half of the community. Instead, he attempts this kind of a disposition: "All of our community property, my half and my wife's half, is to go to my wife in trust for life, remainder to our children." Bear in mind that even with this type of provision the property is still taxed only one-half to the husband when he dies. This was decided a number of years ago when the Commissioner of Internal Revenue claimed unsuccessfully that where the husband attempted to dispose of all the community, it should all be taxed in his estate. The Commissioner has since acquiesced in that decision which made one-half only, taxable in the husband's estate. Also, we don't have to leave it to the wife in such a fashion as to have it taxable at her death in order to get a marital deduction. We don't have to worry about that when we are dealing with community property.

Estate Tax at Later Death of Wife

Superficially then, it seems that we have escaped the tax at the death of the wife; half of the property was taxed when the husband died, and the wife has only a life estate with some limited powers of invasion which can be quite broad and yet not be taxable. Actually, however, what is the situation? The husband has given his half of the community property to the wife and the children. There will be

no tax when she dies. The tax was paid on his half at his death and he is only giving her a life estate in his one-half of the community; but as to the wife's half, the wife has really given one-half to herself and the children by acquiescing in what the husband has set up. Instead of claiming it outright, she has really made a present gift of a remainder interest in her half of the community property, and the cases are very clear now that a gift tax is payable. May I emphasize that we are talking about ordinary community property now, and not about insurance or any other complications. When the husband dies with a provision of this kind, that is, a life estate in the wife in all the community property, and the wife goes along with this provision in her husband's will and elects to leave it in trust, she is in effect making the gift of her half just as clearly as if she put that property in trust directly. She has made an inter vivos gift of the remainder interest to the children, the value of which will depend on her age.

Furthermore, her entire interest put in trust in this fashion will be included in her gross estate at her death, under Internal Revenue Code, § 2036. This is a reserved life estate situation where the entire value of the property, not merely the remainder interest or her life estate, will be included in her gross estate for estate tax purposes, with some credit for the gift tax which was paid on the remainder interest. Thus there is apparently no community property advantage in such a situation. It would seem that the end result is the same as in the case of the marital deduction trust which must be taxable at the wife's death. I am sure that is what Congress was thinking about —half of the tax when the husband dies, the other half when the wife dies.

Widow's Election

But, and this is the big point in a community property jurisdiction today, suppose the husband adds in his will the very familiar clause to the effect that all of the community property, his half and his wife's half, is to go into a testamentary trust, life estate to the wife, remainder to the children, but if the wife elects to take her half outright instead of leaving it in trust, then she is not to get a dime out of his half of the community property. He doesn't state it quite that crudely, but that is the effect. She is cut off from any interest in the husband's half of the community property if she doesn't elect to go along with the trust he has set up, even though it takes in her half of the community as well as his. Why did he do this? Again there are the old reasons—it is a little added pressure on her to get her to elect to put her half in trust and keep only a

life estate so that other third persons, possibly later husbands, won't get their hands on it. Again there is frequently the feeling that the wife is much better off with her half in trust—and I am sure she is, in many cases—than to have this property outright. In addition, today it seems that there are new tax reasons for doing this, both with respect to the gift tax and the estate tax.

There have been two recent decisions of significance to your jurisdiction. One was *Siegel*,[5] arising in California; the other was *Chase National Bank*,[6] arising in Texas. Both of these cases held that where the husband put all of the community property into a testamentary trust, the gift of a remainder interest to the children that the wife was deemed to have made would not be taxable to the extent that she got something from the husband. What did she get from the husband? She got a life estate in his half of the community property. It is a bargain transaction. The husband says, "I will give you a life estate in my half of the community property if you will give our children a remainder interest in your half. You have in effect a life estate in the entire property now." The husband, of course, is giving a remainder interest to the children in his half and that is taxed at his death. The difference in value between the life estate which the wife gets from the husband's estate and the remainder interest in her half depends upon the age of the wife. The Regulations point out, for example, that if the widow is age 51, the life estate and the remainder interest are approximately equal in value.[7] So if he gives her a life estate in $1,000,000, the value of his half of the community property, it is a transfer to her of $500,000; and if she gives a remainder interest in her $1,000,000 worth $500,000, there is adequate consideration and no gift tax is due. Both the *Siegel* and the *Chase National Bank* cases held that under those circumstances no gift tax was payable.

What is the estate tax situation? In the absence of the type of provision which forces the wife to an election there is an estate tax on the entire interest of the wife—$1,000,000—assuming that is the value when she dies. I see no reason why the consideration argument isn't equally valid so far as the estate tax is concerned. The Internal Revenue Service is now in the process of taking up some of these cases. The argument is being made that there is a distinction between the estate tax and the gift tax, and of course there is, in the matter of valuation. When the wife dies leaving this $1,000,000 estate, that million dollars would be included in her estate; it was

[5] Mildred Irene Siegel, 26 T.C. 743 (1956).
[6] 25 T.C. 617 (1955).
[7] 26 C.F.R. § 20.2031-7 (1959).

a reserved life estate under Internal Revenue Code, § 2036, that she set up during lifetime by acquiescing in the husband's will, and the consideration she received, assuming again a 51-year-old widow, was only $500,000, the value of the life estate in the husband's half. So in her gross estate she will not have $1,000,000, but $500,000. In the case of an older person the remainder interest is going to be greater and the life estate is going to be less. In the case of a younger widow, where the remainder interest is not as valuable, you may get to the point where you have almost as much consideration —it will never be quite as much—as the total value of the wife's half. Of course, you can have cases where the husband in addition says, "I leave you a life estate in my half plus my separate property in return for your acquiescence in this trust," and you may well have enough consideration moving to her to equal the value of her community property half, and there may be no estate tax.

Needless to say, this type of consideration makes the Commissioner very unhappy. And yet, the provisions of the Internal Revenue Code which refer to a gift made in contemplation of death, or to the setting up of a revocable trust, or to a reserved life estate, or to any one of the inter vivos gifts that are taxed in the gross estate, all have the provision "except in case of bona fide sale for an adequate and full consideration in money or money's worth." In all probability Congress was thinking about consideration that would still be in the wife's estate when she died, a substitute for the thing she gave away. Here, however, she received a life estate in the husband's half, which is going to be worth nothing when she dies, and therefore there will be nothing to be taxed. It is that which makes the Commissioner very unhappy. But the Tax Court has said that the life estate is consideration none the less, and the fact that it becomes worthless at the wife's death is immaterial. If a different result is desired, taxwise, it is up to Congress to do something about it. This is a community property advantage that can be made use of in Arizona as well as in California if the property is left by testamentary disposition.

Both the *Siegel* and the *Chase National Bank* cases went up on appeal and were decided in the appellate courts within the past two years. These decisions are of particular interest to us. The *Siegel* case went up to the Ninth Circuit which upheld the Tax Court, finding nothing wrong with that court's reasoning.[8] Although this was not an estate tax decision but a gift tax decision, the court said that clearly the husband put the wife to an election here; she was to get nothing in his half if she did not go along with the trust. If she elects to take her half of the community property and foregoes the interest

[8] Commissioner v. Siegel, 250 F.2d 339 (9th Cir. 1957).

in the husband's half, there is no gift tax for she has her half outright and hasn't given it to anybody; at her death, however, if she still has the property, there will be an estate tax. If she elects to go along with the arrangement, there may be no gift tax, depending upon the age of the widow. The younger the widow, the less valuable the remainder interest in her half, which she is giving up, and the more valuable the life estate in the husband's half, which she is receiving. If she receives more than she gives up, there is no gift tax. So you may have a situation of half a tax at the husband's death, and no tax, or a substantially lower tax, on the remainder interest when the wife dies.

Commissioner v. Chase Manhattan Bank

The case which merits our closest attention, however, is the *Chase Manhattan Bank* case which came down a few months ago in the Fifth Circuit.[9] Although you are not in that circuit, the case involved Texas community property law which in many respects resembles your Arizona community property law. In that case there were three different dispositions of property made by a Mr. Moran, the president of Continental Oil. Chase Manhattan Bank was the trustee and the problem was one of transferee liability.

The number one disposition was the testamentary trust which consisted of something over $1,000,000. Here the Fifth Circuit disagreed with the Tax Court, and concluded that the husband had not in unambiguous terms put the wife to an election, in contrast to the *Siegel* case in California where the husband had done just this. The court pointed out that here the husband spoke in general terms about "leaving all my property in trust" and so on, and did not say specifically "all my community property and all my wife's community property." Nor did he specifically say that the wife could have no interest in his half if she did not go along with the arrangement that he had set up with reference to her half. The court suggested that if the husband had used this specific language, the wife would have been forced to an election according to Texas law (and I believe the same would be true under Arizona law). But since she was not forced to an election, the court held that the wife could take both the interest given her in her husband's half of the community property, and also her half outright. The fact that she did not realize what was going on, and had left all the property with the trustee was said to be immaterial. The court was of the opinion that the trustee was really holding all of her property for her as the outright owner, and not merely as the life tenant. The Tax Court was said to have

[9] Commissioner v. Chase Manhattan Bank, 259 F.2d 231 (5th Cir. 1958).

misread Texas law. The wife was not put to an election, and therefore there was no gift tax. She owned her half outright, and had not given a remainder interest to the children. That part of the will purporting to set up the testamentary trust was completely ineffective. There will, of course, be an estate tax when Mrs. Moran dies, upon her half, assuming that she hasn't spent it before that time.

Disposition number two by Mr. Moran was an insurance trust. Judge Wisdom, one of the newer judges on the Fifth Circuit, took about 25 or 30 pages in the Federal Reporter Second to discuss the problems of the insurance trust. There was need for a sound and comprehensive analysis of these problems, and I think Judge Wisdom did a superb job. He tried to disentangle the confused Texas cases which dealt with community property life insurance and concluded that under Texas law, where the husband provides in the insurance policy that all the proceeds are to go into trust, with a life estate to the wife and remainder to the children, the wife cannot claim anything at death. Here again there was no election possibility. The wife could not elect to take half the proceeds outright; she had to leave it in trust, with a life estate to her, remainder to the children. The Tax Court had also reached the same conclusion insofar as Texas community property law was concerned, but then went on to find that the wife had no election at death, and therefore could not be in the position of making a gift of the remainder interest to the children.

The Fifth Circuit, however, said that there was a gift tax payable automatically when the husband died, and the Regulations bear this out with reference to Louisiana and Texas (and the same thing would apply in Arizona). Prior to his death the husband is the agent for the community and, as such, he bought community insurance and paid for it out of community property. It has therefore become community property life insurance. At death, assuming that it was not in fraud of the wife (when he leaves her the life estate it is hard to argue fraud and the cases are pretty clear that there is no fraud), she has to go along with that arrangement; and, as of that time, half of the proceeds—not the premiums, but the much higher-valued proceeds—less the life estate which she has in the property, are automatically deemed to be a gift from the wife. The fact that she can't do anything about it is immaterial; the husband has made the gift for her. It was revocable, so there was no gift during his lifetime; but as soon as he dies it becomes irrevocable. Half the proceeds then go into the husband's estate for estate tax purposes and half the proceeds are a gift from the wife to the extent they have been given away. Here there was a gift to the remaindermen.

This was the holding in the *Chase* case and it is borne out by the Regulations.

When Mrs. Moran dies there will no doubt also be an estate tax on her half of these insurance proceeds. She has, again through her husband, set up a life estate situation for her benefit; and when she dies, there will be a complete estate tax on her half of the insurance proceeds, less any credit for the gift tax that was paid on the remainder interest. There is no possible consideration argument here, for the wife has no choice. That result follows from Texas law. The husband during lifetime can make a gift of life insurance, and the court has refused to treat this any differently from other inter vivos gifts. The fact that he retains the right to change beneficiaries does not make it a testamentary disposition. The court said that this was a lifetime transfer, with the consequences above described. The husband was the agent for the wife as to her one-half. Thus we find that one penalty for the ability of the husband in Texas, and in Arizona, to force the wife to accept a life estate by means of an inter vivos insurance trust is the inability to use the consideration argument available in the case of a testamentary trust.

In California you can employ the consideration argument with respect to all community property, including insurance, because, as you will recall, even in the case of insurance the wife has the absolute right to one-half of the proceeds at her husband's death. The husband can force her to an election and reduce gift and estate taxes by means of the consideration argument. She receives the same protection in all community property, whereas in Texas and Arizona there is a sharp distinction between the inter vivos dispositions, such as insurance and the revocable trust, even though testamentary in nature, and the testamentary disposition. To summarize again, in Arizona the husband has the advantage (he looks on it as an advantage) of forcing the wife by means of an inter vivos disposition to take a life estate in the whole property, remainder to the children, but by so doing he foregoes the possible advantage of being able to avoid gift and estate taxes.

There was a third disposition in the *Chase* case in addition to the testamentary trust and the insurance trust. This was an inter vivos revocable trust created some 20 years previously in New York, but involving community property. The wife claimed that this trust should be treated the same as a testamentary disposition and that she should have the right to elect to take half of it under Texas law. She also claimed that this trust was a nullity—a sham trust. The court of appeals did not agree. It said that this was an inter vivos disposition, that revocable trusts are recognized, and that the

husband's rights in the trust were to be governed by his rights during lifetime, not by his more restricted rights at death. Applying this to Arizona, the husband can, by an inter vivos disposition—either by a revocable or insurance trust—force the wife to take a life estate in all personal property. This is in sharp contrast to his rights in personal property at death, but there is a tax price—there is no consideration argument to avoid or reduce the gift or estate tax. There will be an automatic gift tax at the death of the husband where an insurance or revocable inter vivos trust is involved, and an estate tax at the death of the wife.

Inter Vivos Gifts of Insurance

It will often be desirable in Arizona where the husband has named some third person as life insurance beneficiary or partial beneficiary—such as remainder interest to the children if it is a life insurance trust—for the husband to make that gift complete before his death. The wife, for example, would do well to release her community property interest before the husband dies.

That brings up the *Goodman* case in the Second Circuit[10] where there was a comparable situation. It wasn't community property, but the wife bought and owned life insurance on the husband. The cash surrender value—more accurately, the terminal reserve figure, the replacement value—was about $100,000 the day before the husband died. After he died, the proceeds were $500,000. The beneficiary was a third person, and as of death the gift became complete. This was a gift from the wife, the lifetime owner. She owned the policy, and the husband was merely the insured; his life merely measured the policy. When he died she was deemed automatically to have made a gift of $500,000 to the person who got the proceeds. Had she assigned this policy the day before her husband died, the gift would have been $100,000 and not $500,000 because it would have been measured by the lifetime value of the insurance policy. The same thing can be true in California or Arizona or in any community property state if the wife assigns her interest in the insurance policy to the third person beneficiary, and if the husband does the same thing. There is no problem, so far as the wife's interest is concerned, of a gift in contemplation of death since it is not a gift in contemplation of her death. The gift will be measured by the lifetime value and not the much greater proceeds value. So far as the assignment by the husband of his half is concerned, it may be a gift in contemplation of death, but if he has the incidents of ownership, that half is going to be included in his gross estate anyway.

[10] Goodman v. Commissioner, 156 F.2d 218 (2d Cir. 1946).

Prior Death of the Wife

Now let's turn to the second situation, that is, the case where the wife predeceases the husband and there is community property. Here Congress failed to equalize the tax treatment of community property states and non-community property states. In a non-community property state, assuming that the husband has acquired property amounting to $2,000,000, if the wife dies first, there is no marital deduction. Although there is no tax when the wife dies, there is a full tax when the husband dies, and the benefit of one $60,000 exemption is lost, since there is nothing in the estate of the wife. The community property states, on the other hand, have a built-in marital deduction. When the wife dies, half of the community property is taxed; but she can, by bypassing the husband with her half, either by a gift directly to the children or by a life estate in her half to the husband, avoid a tax on her half when the husband dies. Of course, if she leaves all of her interest to her husband, there will be a tax on half when she dies and a full tax when he dies, but that doesn't have to follow. I think that there is much less danger in Arizona of this one-half plus a full tax because of the Arizona law of intestate succession. If the wife doesn't make a will, her half goes to her descendents and will automatically bypass the husband. That is not true in California where if the wife doesn't make a will, and frequently she doesn't, all the community property goes to the husband.

With reference to the estate tax when the wife dies, the wife does have a power of testamentary disposition in all community property states with the exception of New Mexico. About two years ago I spoke to the Nevada bar, and at that time Nevada and New Mexico did not give the wife a power of testamentary disposition. I pointed out that they were going to get into some tax difficulties; the wife's interest would automatically go to the husband and you couldn't bypass the husband and save taxes. Furthermore the Internal Revenue Service had just decided that, testamentary power or not, they were going to tax half of the community property when the wife died because she had a substantial enough interest in it. So there would be half a tax when the wife died and a full tax when the husband died. I had a letter from the president of the State Bar of Nevada about six months later, saying that Nevada had changed its law, and now the wife is given the power of testamentary disposition. I haven't heard that this has been done in New Mexico, but the wife clearly has that power in Arizona and in all the other community property states. Whether she has it or not, she apparently pays an estate tax on half of the estate when she dies first.

We now come to the intriguing question: Is community property life insurance any different when the wife dies first? The husband has taken out the policy, he is the insured, and the wife's name is not found anywhere in that policy. He can, of course, take out such a policy and can use community funds to pay the premiums. What is the nature of the wife's interest when she dies first? There are two tax cases in the federal district courts in California that are at complete odds on this point. A federal district court decision from Southern California, *California Trust Co. v. Riddell,*[11] held that when the wife dies first, having an interest in community property life insurance on the husband's life, there is to be included in her gross estate her half interest in the lifetime value of that insurance policy. I can't see any escape from that conclusion. It is true of community property generally. Why should it be any different with respect to community property life insurance? And yet the federal district court in Northern California came to the opposite conclusion in *Stewart v. United States.*[12] The court said that the wife doesn't have any interest in this policy since there is nothing she can pass on; she can't give it to her heirs, and her executors can't reach it. This question has not been passed upon by the California courts.

There is a recent Texas case, *Thompson v. Calvert,*[13] holding squarely that the Texas inheritance tax is applicable to the wife's half interest in Texas community property life insurance when she dies first. Bear in mind that the wife's interest in life insurance, certainly after the husband's death, is far less in Texas and far less in Arizona, than it is in California; and yet despite that fact the court squarely recognized that when she dies first, her interest in that community property is just as taxable as her interest in any other community property.

In the *Chase* case the court stressed the wife's rights in a community property life insurance policy, under Texas law, even if she doesn't have substantial rights in the proceeds. Arizona law may well be similar. A rather interesting ruling of the Attorney General of Texas was to this effect: A wife may will half of the community property life insurance to whomsoever she pleases and this will pass, even under a general residuary clause. This is permissible under the community property life insurance law of Texas, and presumably it is true under the Arizona law. The ruling was made in June of 1958 and it seems perfectly logical. And yet attorneys, life insurance companies, and judges still seem to be confused.

[11] 136 F. Supp. 7 (S.D. Cal. 1955).

[12] 158 F. Supp. 25 (N.D. Cal. 1957). Since the date of the speech, this case was reversed in United States v. Stewart, 270 F.2d 894 (9th Cir. 1959).

[13] 301 S.W. 2d 496 (Tex. Civ. App. 1957).

Confusion as to Nature of Wife's Interest

Let us examine just what the reasons are for the confusion in this matter of the nature of community property life insurance and, more specifically, the wife's rights therein. You will find the courts saying, time and time again, that there is no property interest in life insurance. That statement is made in some of the earlier Arizona cases. I think it stems in large part from the cases around the turn of the century when there really was nothing of value in life insurance policies during lifetime. By and large those were term insurance policies—somewhat like fire insurance. Today that is not true in most cases. There can be substantial lifetime values. Where the language of a case deals with term insurance I don't think it is very meaningful.

Secondly, I think there is a failure on the part of many to distinguish between the contractual rights of an insurance company, as set forth in their agreements with the insured as to whom they shall make the proceeds payable, the terms, and so on, on the one hand, and the property rights, the ownership rights, on the other. The companies ignore this distinction in selling community property life insurance, and a confused situation may result.

In the third place, it is argued that the heirs of the wife should not have any greater rights in the community property life insurance policy than the wife herself had. The argument is made that the wife during lifetime cannot cancel the policy and cannot go down to the company and say she wants the cash surrender value or any part of it, for the husband is the manager of the community property. Yet under Texas law, and I think under the law of any community property jurisdiction, the heirs should be entitled to their part of the policy. You can partition a life insurance policy. The practical objections that come to mind are not insurmountable. You can get the company to issue two distinct policies, both of which will still be on the life of the husband. The husband will own one-half of the insurance; and the individual to whom the wife left the policy, if someone other than the husband, will own the other half. It will no longer be community property. Compare a hundred shares of General Motors stock. The wife can't go down and have that split into two 50-share certificates, short of divorce or something of that kind—and yet upon death, if the wife leaves her half to the children, quite clearly the children can have the stock split. I see no reason why community property life insurance is any different.

In the fourth place, there has been a failure on the part of many to distinguish between the rights of a beneficiary and those of

a co-owner. In separate property states the wife can also be an owner or co-owner of a policy, but she is not as likely to be, as in a community property state, where she automatically becomes a co-owner if it is a community property life insurance policy. The wife has these rights of ownership whether she is named as beneficiary or not.

In the fifth place, there is a failure in Texas and Arizona to recognize that insurance is inherently testamentary. Certainly where the husband reserves the power to change beneficiaries the courts should treat the wife's interest—I'm talking now about the case where the husband dies first—the same as they would treat anything left to her under a will. Maybe it will require a statute to bring recognition of this principle, but it seems to me that an attorney could well use this argument before the Arizona courts where the rules in this field are not too well settled. I believe that the same should be true with an inter vivos revocable trust. In other words, even if you continue to allow the husband to give property away without any strings during lifetime so long as he does not defraud the wife, you should not permit him to bypass the limitations on his testamentary power by means of these lifetime transactions that are inherently testamentary in nature.

In the sixth place, it seems to me that some of these decisions fail to recognize that the wife's heirs should have the same rights in a community property life insurance policy when she dies first that she would have in the case of divorce. The Arizona law is clear with respect to the divorce situation. *Blaine v. Blaine*,[14] and other cases, hold that the wife does have an interest in the surrender value of the policy upon divorce, if it is a community policy. I have mentioned the recent ruling of the Attorney General of Texas which concluded that the wife can dispose of her half of the community property life insurance by will and that she can do so by a residuary clause. And yet there is a sharp distinction made in Texas when the husband dies first. His inter vivos power makes it possible to at least limit the wife's interest in the proceeds and he can disinherit the children entirely, leaving a life estate to the wife and the remainder interest to someone else, if effected during his life. This creates the anomalous situation that it may be better for the children if the wife predeceases the husband than if the husband predeceases the wife where the father is of a mind to disinherit the children. Where the wife dies first, the children can get an interest in the policy by becoming

[14] 63 Ariz. 100, 159 P.2d 786 (1945).

tenants in common with the father under the Texas ruling, irrespective of the desires of the father.

Seventh, I think there is a failure on the part of many courts to distinguish between rights in a policy and rights in the proceeds. Insurance does consist originally of rights in a policy—lifetime rights—and later of rights in the proceeds, and I see no reason why the wife's community property interest should be any less protected in one case than in the other.

Eighth, and last among the reasons why there has been confusion in this area is that insurance policies do present complicated problems of valuation. The tax authorities and the courts by and large have tended to limit these values to two, either the cash surrender value (terminal reserve is the more accurate figure), or the face value at death. Obviously there can be many other values and this leads to complications. Take term insurance, for example, owned by an individual who knows he has cancer and has not long to live. That can be a very valuable policy and yet one on which it would be difficult to place a value.

The problem of whether the children get any part of the insurance interest is likely to be more acute in Arizona than in California, because of the fact that all of the wife's interest in community property will go to the children if there is no will. The big question is: Does this include interests in community property life insurance? In California very frequently the wife doesn't leave a will, or if she leaves a will, she leaves everything to the husband. Even if she leaves a will passing all of her interest to the children, she usually doesn't mention the interest in insurance and the attorney never thinks about it. It is questionable whether it was intended to pass by the residuary clause. Thus in California there is very likely to be a tax on half of the lifetime value of the policy when the wife dies and then, because the property all goes to the husband, on the full proceeds at his death. In Arizona, community property should more frequently pass to the children at the wife's death and I can see no reason to conclude that the wife's interest in community property life insurance in Arizona should not be similarly treated.

Conclusion

Life insurance contracts are technical and complex. They are susceptible of great variation. They have proved difficult to equate with other property concepts and from the outset have defied the efforts of Congress to catalogue. Congress has vacillated back and forth on the taxation of life insurance—as have the courts and the

taxing authorities—and no one has come up with a consistent scheme for taxation. This difficulty has been compounded in a number of states by the necessity of accommodating a community property system to a type of contract that was primarily a product of the common law. I believe, however, it is important to recognize that life insurance is merely another form of property, and that it is community property if such funds were used to purchase it. The wife's rights should be protected to the same extent in such property as they are in any other form of property and the tax consequences should follow accordingly.

DISCUSSION

Comment by Joseph T. Melczer, Jr.*

Dean Lyons, Mr. Thurman, ladies and gentlemen. The most appropriate comment that I can make concerning Mr. Thurman's talk is that it was a most thorough and clear presentation of his subject. I would like to ask Mr. Thurman one question concerning the story he related with respect to the exchange of the two twenty-year squaws for the forty-year squaw. Mr. Thurman, would you tell us if the exchange would be treated as a tax-free one?

Mr. Thurman elaborated on the advantages that can be secured in certain instances by use of the widow's election. As he pointed out, this poses certain gift and estate tax problems. He referred to the *Siegel* case which was decided by our Ninth Circuit Court. Judge Yankwich, from the District Court in Southern California, wrote the opinion, sitting with the Ninth Circuit on that particular case.

In the *Siegel* case the taxpayer and decedent were husband and wife, residents of California. Siegel died in California in 1949 leaving an estate consisting entirely of community property. The will provided that the provisions in the will for the taxpayer were in lieu of her community rights, and if she elected to take her community interest, then the provisions for her under the testamentary trust were to be of no force or effect. The taxpayer filed an election to take under the will. The Commissioner contended the taxpayer made a transfer of her remainder interest in one-half of the community property to her son, the remainder-

* Member of the Phoenix Bar.

man, without adequate consideration and assessed a gift tax in the amount of $51,144.24.

The Tax Court held that only the excess of value of her transfer over what she received was a taxable gift and determined the gift tax payable was in the amount of $4,314.87. The taxpayer was represented by Dana Latham, the present Commissioner of Internal Revenue.

The Ninth Circuit affirmed the Tax Court, holding that the amount of the gift should be measured by the taxpayer's community interest reduced by the present value of her life interest in the entire community property and a specific bequest of $35,000 granted to her under the will. The Ninth Circuit held that the property surrendered was consideration for that which was accepted.

I believe that the *Siegel* case is a very well-reasoned case and that the court was correct in holding that the property was a valid consideration for that which was accepted by the widow under the will.

There was a recent case in the Sixth Circuit that may be of some interest, the case of *Commissioner v. Vander Weele.*[1] Mrs. Vander Weele created an irrevocable trust, of which she was the sole life beneficiary, consisting of stocks, securities, and a contingent remainder interest in a trust created by the will of her grandfather. At the time the trust was created, the total value of Mrs. Vander Weele's stocks and securities and her remainder interest in the testamentary trust of her grandfather was $592,905.08. Under the terms of the trust Mrs. Vander Weele was to receive the trust income for life or until the receipt of the remainder interest in her grandfather's estate. Thereafter the trustees were empowered to pay her so much of the income of the trust as they in their discretion deemed desirable and ample for her comfortable well being and enjoyment. Upon receipt of the aforementioned remainder interest, the trustees were directed to pay to Mrs. Vander Weele $10,000 from the principal and an additional $10,000 therefrom every five years during her life.

The trust agreement provided that in the event the amounts so payable to Mrs. Vander Weele did not in the sole judgment and discretion of the trustees provide for her comfortable well being, the said trustees might from time to time pay to her such part or all of the principal of the entire trust estate, or any portion of the trust estate resulting from the accumulations of net income, as to said trustees in their sole judgment and discretion seemed advisable, without regard to any obligations set forth or implied to preserve or conserve any of the trust estate for her husband or any of the other beneficiaries designated in the trust agreement.

[1] 254 F.2d 895 (6th Cir. 1958).

Relying principally upon its decisions in *Alice Spauling Paolozzi,*[2] and *Estate of Christianna K. Gramm,*[3] the Tax Court held that the execution of the Deed of Trust by Mrs. Vander Weele did not constitute a gift taxable under the Internal Revenue Code of 1939. The United States Court of Appeals for the Sixth Circuit affirmed the decision of the Tax Court. The circuit court stated that the trust conveyance in effect created no completed taxable gift to the remaindermen and that there was no assurance that anything of value would pass to the remaindermen. The circuit court pointed out that Mrs. Vander Weele could in actuality retain the economic benefit and enjoyment of the entire trust income and corpus by borrowing money or by selling, assigning, or transferring her interest in the trust fund and relegating her creditors to the trust fund for payment. The circuit court further pointed out that it was not confronted with the decision on "the donative intent" for there was no gift whatever in praesenti, only a transfer which, upon contingencies, might become a gift at some future time. The court further stated parenthetically that, from the standpoint of practical taxation, the trust agreement made by the taxpayer did not necessarily cause the government to lose revenue, but would have the tendency to preserve the property transferred in trust for estate tax taxation.

Comment by Devens Gust*

Today we have heard about some recent modifications in our property law, brought about not only by legislative action, but also through state and federal court decisions, all of which have the force and effect of law, and it's easy to see why we as general practitioners of the law are not able to keep up to date on these changes. Particularly, to my mind, is this true in the field of federal taxation. Here the ordinary rules of common sense and logic, and the way of handling law problems which was instilled in us in law school, seem to have little or no application. Perhaps it's the language that's used in writing these laws and regulations. Because the law is so complicated, because it is continually changing, I think that institutes such as we have had here today are about our only means of keeping ourselves up to date. Here we can spend a few hours of our time and get the benefit of a great deal of thought and research and experience from men who have specialized in a particular field of law. I hope that the university law school and the continuing legal education committee of the State Bar will have more of these institutes for us.

[2] 23 T.C. 182 (1954).
[3] 17 T.C. 1063 (1951).
* Member of the Phoenix Bar.

One case which was discussed rather thoroughly by the speaker was the *Chase Manhattan Bank* case. In my opinion it is a very interesting, a very thorough, and a very well-written opinion. Incidentally, I might mention that Judge Wisdom, when he wrote this opinion, apparently relied rather heavily on Mr. Thurman, our speaker here today, because not only did he cite the law review article which Mr. Thurman has written on this general subject, but the text of the opinion shows that he rather liberally accepted Mr. Thurman's ideas. The thing in this case that interested me particularly, aside from the technical aspects, was the burden that the court placed upon the Commisisoner of Internal Revenue. As all of you know who have dealt with the internal revenue officials, the scuffle between the taxpayer and the government is not one that you could call an equal contest. It's always hard to argue about money with a man when he can put his hand in your pocket and take whatever he wants. But in this case I think the court recognized that fact. The taxpayer had taken one position throughout the early part of the litigation. By the time the case got to the court of appeals some Texas attorneys were brought in. Prior to that time, apparently no one working with the case on either side had much of an idea of community property. When the Texas lawyers came into the case, when it went to the circuit court, there were some rather drastic changes in theory; in fact the bank in several respects almost completely reversed or changed its position, and naturally the Commissioner screamed like an eagle when that happened, because he felt that that was taking improper advantage of him.

Judge Wisdom in his opinion had this to say. "'Indeed,' says the Commissioner, 'the taxpayer invited error.' We think that the taxpayer did invite error. Worse, the invitation was accepted. But an appellant has no vested right in an opponent's error of law in the lower court, especially when the protesting appellant is the Commissioner of Internal Revenue. The Commissioner owes a duty to the United States Government to litigate zealously in the interest of collecting taxes, but he owes a duty to all taxpayers, including the litigating taxpayer, to see that the tax law is applied justly." And I was very glad to read that. I was very glad because it seemed to me to be somewhat of an answer to those internal revenue agents and their superiors who apparently feel that they must take whatever position results in the greatest tax to the government. This case clearly shows that the internal revenue agent and those in the service should take the position which is fair and just. I might add that my dealings with our local people here have been very good; I think they are very fair in that regard. But I think elsewhere the trend has been very much the other way.

Specifically, I would like to mention one or two thoughts that I had on listening to Mr. Thurman's talk. One situation that interested me particularly was the one where the wife dies first, and there is community life insurance on the husband's life. I have just recently had that situation arise and it was a puzzle to me at the time. Of course, normally we plan our estates so that the husband will die first, and it crosses us up when the wife goes first, and then we have to think about things that maybe we should have thought of before and didn't. In the case I had, that was exactly my problem. The wife died first. There was some life insurance on the husband's life which was purchased with community funds. The question was: Should there be any mention of that made on the estate tax return? I didn't know what to do with the matter when I wrote up my inventory and appraisement to file in the probate court. I didn't know whether or not to put in half of the cash value as an asset of the estate; and on reviewing a little on the tax regulations, it appeared to me that they took the position that the replacement value, or one-half of the replacement value, should be included in the wife's estate. I had a little trouble finding out what the replacement value was. I wrote the insurance company, asking them to send it to me, and after going through a number of offices and ending up in the home office, I finally put in the cash value, which was all that anyone could seem to give me. I don't purport to have the right answer on this—whether you should list the cash value in your inventory in the probate estate or not. I did, because I figured that was the most logical solution. I do think that there has been a Washington case—the state of Washington—which has held contrary to the Texas cases. The Washington case held that since the executor of the wife's estate has no way of taking hold of this half of the replacement value or half of the cash value, it should not be subject to tax. So I think that there is a real split of authority on it, and it is very helpful to us that our speaker today has given some very cogent reasons why the wife's share in that should be taxed.

In concluding my comment I shall follow precedent by asking the speaker a question. We have this factual situation: The husband and wife have community property, one of the assets being a life insurance policy purchased with community funds. The husband, in working out his estate plans, names his estate as beneficiary—that is, the executors of his estate. At that time he makes the wife the beneficiary under the will which sets up a trust and gives her a life estate. Subsequently, the husband becomes enamoured of another lady and then he changes his will, making the girl friend the beneficiary.

Is that a transaction which, under the law of Arizona, the wife could set aside as being in fraud of her rights?

MR. THURMAN: One comment on the first observation of Mr. Gust. The *Chase* case was indeed very interesting from the standpoint of the change of theory on appeal. I don't know how many of you would be that lucky, though, and be allowed to change your argument that drastically. In New York they had some high-powered counsel before the Tax Court, and apparently every one conceded there—both the Commissioner and the New York counsel—that the husband had without question put his wife to an election and she had to take what he had set up by will before she got anything in his half. Consequently, the consideration argument was made out. Then these Texas attorneys got into it and pointed out very promptly to the court that the argument did not square with Texas community property law, and the court went along with them and in substance said, "We don't care if you're changing your theory. We agree that under Texas law this was not tantamount to putting the wife to an election; it was not sufficiently unambiguous." So the Texas lawyers were quite fortunate in that instance, and it was a little unfair to the Tax Court, because it didn't have the benefit of any of this argument under Texas law.

On this problem that Mr. Gust put, it seems to me that he has described the one situation where the cases have uniformly held, both in Arizona and Texas, that the transaction is in fraud of the wife; that is, when the husband names his estate as the beneficiary. In other words the husband can make a gift by means of insurance to third persons, but he can't make a gift to himself or to his estate, and when he compounded that by leaving everything to the girl friend, under the will, I would think you would have a very good argument that this was in fraud of the wife.

Comment by John L. Donahue, Jr.*

Of the many aspects of community property life insurance which Mr. Thurman has just discussed, I would like to comment on the *Siegel* and *Chase Manhattan* cases in connection with the widow's election.

Mr. Thurman has pointed out that in order to effect the widow's election the will, or other document in inter vivos transfers, must purport to dispose of not only the husband's half of the community property but the wife's as well, and that in exchange for agreeing to this arrangement the wife obtains a life interest in all of the community property. As you will recall from Mr. Thurman's discussion

* Member of the Tucson Bar.

of the *Siegel* case, the husband's will purported to give the surviving wife a life interest in all of the community property, and the remainder over to an adopted son. The Commissioner assessed a tax of $51,144 as a gift tax on the transfer of the remainder interest in the wife's share of the community property to the son. The Court of Appeals for the Ninth Circuit reduced the tax from $51,144 to $4,315, a tax savings of $46,829, by allowing the wife to deduct from the remainder interest she gave (by her election to take under her husband's will) the value of the life interest in her husband's share of the community property which she received. In other words, the consideration for the remainder interest she gave was the life interest she received.

The question which comes to my mind is this: What about an inter vivos insurance trust featuring a widow's election in Arizona? In California, Mr. Thurman points out that increasingly, insurance proceeds are left in trust, the wife to receive the life income on all the insurance proceeds only if she consents to placing her half in the same trust. The wife in California, however, has well settled and substantial rights in life insurance and may avoid entirely any gift as to policy rights during the insured's life and to the extent of one-half the proceeds after death. The wife in California, then, has much to give up when she consents to an inter vivos insurance trust with the usual widow's election provisions. But what about Arizona? In Arizona, as in Texas, the husband has the absolute right to dispose of community personalty as he sees fit just so long as it does not constitute a fraud on the wife. As you well know, in *Gristy v. Hudgens*[1] the supreme court disposed of the argument that the husband had defrauded his wife in making a policy payable to an eleven-year-old minor who was not a member of the family, saying there was "no showing that the wife had not received even more than her share of the community property."

In the *Chase Manhattan* case, Mr. Thurman points out, the court held that the same power of disposition over personalty in Texas which we have in Arizona resulted in a taxable gift on the husband's death, of her interest in the life insurance less her life interest. In effect, the court held that under Texas law the husband made the gift for the wife of her interest under the husband's almost absolute power of disposition. Clearly, he couldn't have done this in California without her consent.

What, then, would the wife be giving up in Arizona or in Texas when she elects to take under an inter vivos insurance trust featuring a widow's election? In the *Siegel* case the court said she was

[1] 23 Ariz. 339, 203 Pac. 569 (1922).

giving up a remainder interest in exchange for a life interest and allowed the taxable gift to be reduced by the value of the consideration received. But in Arizona and Texas, would the court allow the same reduction in the value of the gift where the husband can dispose of the wife's community personalty whether she likes it or not, except in cases of fraud? An election by the wife in Arizona at best would only constitute a waiver of her rights regarding fraud, and if she were well provided for otherwise and the remaindermen were her children, it is difficult to see there that she would actually be giving up anything.

I would ask Mr. Thurman, then, assuming he agrees the wife is giving up nothing in an inter vivos widow's election insurance trust in Arizona, would that result be avoided by creating a trust which would include real property in which the Arizona wife does have substantial interests?

In the *Siegel* case, being able to use the widow's election reduced the gift tax by $46,000. On the other hand, this may be much ado about nothing if, as Mr. Thurman points out, the election by the widow may constitute the creation of a reserved life estate causing her half interest to be entirely taxable for estate tax purposes, in which event the reduced gift tax may not be an advantage at all.

MR. THURMAN: I believe Mr. Donahue is correct in concluding that the widow's election device is not available in Arizona when an inter vivos insurance trust is involved. The widow will normally have no election to make. Presumably, however, the inclusion of real property in an inter vivos trust could bring the election into play.

In reply to Mr. Donahue's final comment the consideration argument of the *Siegel* case should be applicable in an estate tax case as well as in a gift tax case inasmuch as both types of transfers are exempt where there is a "bona fide sale for an adequate consideration."

ARIZONA LAW REVIEW

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SURVEY OF 1958 ARIZONA CASE LAW

PART II

Evidence

Tom Slutes

Parol Evidence

In *Roseberry v. Heckler*[1] the Supreme Court held that a broker who had a listing which required him to secure a buyer on terms which would be satisfactory to the owner can not establish that he complied with the terms of the listing by oral evidence. This type of contract came under Paragraph 7 of A.R.S. § 44-101 and the broker was required to prove that the owner accepted the terms presented to him with written evidence.

Beaudry Motor Company v. Truax[2] cited the basic rule of parol evidence — that it will not be admitted to vary the terms of a written contract—but held that there was no written contract in this case. The defendant had signed a purchase order for a new car from Beaudry Motor Company but the latter hadn't signed it. There was a provision on the face of the instrument saying that the plaintiff would not be bound by the order unless the order was accepted by it. Also, there were discrepancies between the purchase order held by the defendant and the carbon copy which the plaintiff held; e.g., the cost of a radio was $24 higher and seat covers were an added expense on the plaintiff's copy. The Court held that these orders did not constitute integrated or partially integrated contracts and thus the defendant's oral testimony was properly admitted by the trial court.

Admissions

State v. Van Bogart[3] followed the earlier Arizona cases of *State v. Hernandez*[4] and *State v. Romo*[5] which held that admissions and incriminating statements of the defendant may be admitted in evidence in criminal cases but not until the corpus delecti is established by independent evidence. It was held that the independent evidence must reasonably support an inference of the corpus delecti, and it need not be established by clear and convincing evidence.

[1] 84 Ariz. 247, 326 P.2d 365 (1958).
[2] 84 Ariz. 126, 324 P.2d 1006 (1958).
[3] 85 Ariz. 63, 331 P.2d 597 (1958). See also COURTS AND PROCEDURE, and CRIMINAL LAW, *supra*.
[4] 83 Ariz. 279, 320 P.2d 467 (1958).
[5] 66 Ariz. 174, 185 P.2d 757 (1947).

In a somewhat related matter, the Court in *Hemphill v. Hemphill*[6] considered the effect in a divorce proceeding of a wife's admission in her pleadings of her husband's allegation of residence in the state for the required period. A.R.S. § 25-317 provides that no divorce shall be granted upon the testimony of a party unless it is corroborated by other evidence. The Court in this case held that there was insufficient corroboration of the husband's allegation because the wife's admission in her pleading was negated by her testimony at the trial — her evidence showing that she really did not know where her husband was until just before the trial.

Opinion Testimony

Two tort cases deal with opinion testimony, *Goodman v. Carson*[7] and *Gray v. Woods*.[8] In the latter case, apparently one of first impression in Arizona, the Supreme Court followed the general rule in other states and said that a highway patrolman, testifying as an expert witness, may give an opinion as to the point of impact in a traffic accident where his testimony is based on the damage to the vehicles involved, marks on the road, location of debris on the highway and other indicia at the scene.

In *Goodman v. Carson, supra,* the trial court admitted in evidence certain of the plaintiff's testimony in which he stated his opinion that the accident would not have occurred had the defendant acted differently. The Supreme Court held this to be error, in that a lay witness should confine his testimony to facts only.

In this case the trial court also allowed the plaintiff to testify concerning the speed at which the defendant's car was traveling at the time of the accident. The testimony was based upon experiments the plaintiff and his attorney had made just prior to the trial. This testimony was rejected by the Supreme Court by stating that testimony based upon experiment is not to be admitted unless the witness is an expert and the conditions under which the experiment were made are shown to be substantially the same as those existing at the time of the accident. In his dissent, Justice Struckmeyer objected to both of these rulings. His strongest objection was to the witness opinion rule, arguing that opinion testimony does no harm because the jury, realizing that it is an opinion, would pay it no heed unless it appears to be based on satisfactory data.

[6] 84 Ariz. 95, 324 P.2d 225 (1958). See also DOMESTIC RELATIONS, *supra.*
[7] 84 Ariz. 177, 325 P.2d 819 (1958).
[8] 84 Ariz. 87, 324 P.2d 220 (1958). See also TORTS, *infra.*

Judicial Notice

Murphy v. Gray[9] and *Sparks v. McClusky*[10] were two cases which discussed matters concerning judicial notice which heretofore had not been considered in Arizona. In *Murphy v. Gray, supra,* the Court said that judicial notice would not be taken of records in the county recorder's office, and that competent evidence must be used to establish the authenticity of such records. The *Murphy* case also reiterated the proposition that evidence of a change in property value should not be admitted in a case which seeks to remove equitable servitudes because such change doesn't justify the removal of restrictions.

The Supreme Court in the *Sparks* case said it would take judicial notice of the fact that no properties are assessed at full cash value. While there are no prior Arizona pronouncements on this point, the position is supported by 31 C.J.S. *Evidence* § 54, at 632 (1942), especially note 50 thereunder, which lists several cases in which facts of general notoriety concerning the valuation of property for tax purposes were judicially noticed.

This case also held that the plaintiff need not prove actual fraud in his suit which claimed that his property was being assessed at a higher rate than other like property in the county because the defendant's act in assessing the property in such a manner was admittedly intentional.

Negative Testimony

Southern Pacific Railway Co. v. Cavallo,[11] basically a tort case, involved two evidence points. In this case the plaintiff was struck at a railroad crossing by the defendant's train. He testified that he had heard the engineer blow his whistle only at the last minute and the engineer testified that he had blown it for a long time. The Supreme Court cited *Davis v. Boggs,*[12] an early Massachusetts case,[13] and 162 A.L.R. 9 (1946), both of which agree that mere negative testimony—which usually carries no probative value as against affirmative testimony to the contrary — may be equivalent to positive evidence that a signal was not given if the jury believes the witness was attentive and could have heard the signal had it been given.

On the other evidence point, the trial court allowed the plaintiff to introduce a document which purported to show that in 1953 an average

[9] 84 Ariz. 299, 327 P.2d 751 (1958).
[10] 84 Ariz. 283, 327 P.2d 295 (1958). See also TAXATION, *infra*.
[11] 84 Ariz. 24, 323 P.2d 1 (1958). See also TORTS, *infra*.
[12] 22 Ariz. 497, 199 Pac. 116 (1921).
[13] Menard v. Boston & Maine R. Co., 150 Mass. 386, 23 N.E. 214 (1890).

of 271 cars per day used the highway the plaintiff was traveling. There was no evidence as to who had made the counts, how many were made, or when they were made. The plaintiff claimed the document could be admitted either under Rule 44(a) or 44(q) of the Arizona Rules of Civil Procedure, but the Supreme Court disagreed. Rule 44(a) refers only to a record which the law requires to be kept — definitely not applicable here — and Rule 44(q) refers only to business records. It was held that the vague and uncertain origin of the document precludes it from being admitted into evidence as a business record.

Conflicting Evidence

County of Maricopa v. Shell Oil Co.[14] and *State v. Milton*[15] involved similar points of law which are well settled in Arizona. During the trials of both cases witnesses for the eventual prevailing sides made contradictory statements and the losing parties in each instance assigned these statements as error. The Supreme Court held in both cases that such contradictory statements were not sufficient to destroy the probative value of the testimony but that the evidence should be considered as a whole.

It was also held in both cases that when there is a conflict in the testimony, the Supreme Court will not disturb the trial court's judgment where there is reasonable evidence to support it.

Hearsay Testimony

Hudgens v. The Industrial Commission[16] was a workmen's compensation case which stated that the claimant may use circumstantial and hearsay evidence to sustain his burden of proof that there was a causal connection between his employment and his injury. A.R.S. § 23-942 says that the Industrial Commission need not be bound by the rules of evidence.

Sufficiency of Evidence

Finally, *Prince Development Corp. v. Beal*[17] held that there was insufficient evidence to support a finding of contempt against the defendants for violating an injunction concerning the manner in which the defendants operated their drive-in theater because at the time of the alleged violations of the injunction the defendants were wholly disconnected with the operation of the theater, it being under the control of a receiver.

[14] 84 Ariz. 325, 327 P.2d 1005 (1958). See also PROPERTY, *infra*.
[15] 85 Ariz. 69, 331 P.2d 846 (1958). See also CRIMINAL LAW, *supra*.
[16] 83 Ariz. 383, 321 P.2d 1039 (1958). See also WORKMEN'S COMPENSATION, *infra*, for more complete discussion.
[17] 85 Ariz. 74, 331 P.2d 1091 (1958). See also COURTS AND PROCEDURE, *supra*.

Insurance

Philip Toci

Pacific Fire Rating Bureau v. Insurance Co. of North America[1] concerned the interpretation of a statute in the Arizona Insurance Code pertaining to insurance rating bureaus. The statute in question, A.R.S. § 20-363, provides that each rating organization shall permit any insurer to be a subscriber for any kind of insurance or subdivision thereof for which it is authorized to act as a rating organization. The plaintiff, North American Company, terminated its subscribership for "dwelling classes" and wished to retain subscribership for the remaining services of Pacific Fire Rating Bureau. Pacific Fire Rating Bureau then amended its constitution, the effect of which was to deny partial subscribership to the North American Company. The Director of Insurance approved this amendment. The Insurance Company of North America contended that under A.R.S. § 20-363 it could not be denied partial subscribership and such amendment was invalid in spite of the fact that the Director of Insurance had approved it. The Supreme Court upheld the view of the insurance company and affirmed the judgment of the lower court, saying, "While the Director may, under the statute, approve reasonable rules and regulations he cannot make or approve a rule [the amendment to Pacific Fire Rating Bureau's constitution] as here, that would conflict with the true meaning of the statute."

[1] 83 Ariz. 369, 321 P.2d 1030 (1958).

Labor Law

THEODORE MATZ

The plaintiff in *International Brotherhood Of Carpenters And Joiners Of America, Local No. 857 v. Todd L. Storms Construction Company*[1] was employing all nonunion help on his construction job. He refused to negotiate with the defendant union, and the record clearly showed that there was no dispute between the plaintiff and his employees as to wages and working conditions. Upon refusal to negotiate the union started peaceful picketing of the plaintiff's job, and this suit was brought to enjoin the picketing. A temporary injunction was issued by the superior court.

The case in the lower court was decided in favor of the plaintiff on the basis that the picketing violated A.R.S. § 23-1322. This statute provides, "It is unlawful for a labor organization to picket any establishment unless there exists between the employer and the majority of the employees of such establishment a bona fide dispute regarding wages or working conditions."

After the entry of the order for the temporary injunction the Arizona Supreme Court, in the case of *Baldwin v. Arizona Flame Restaurant*,[2] declared this section of the Arizona Revised Statutes unconstitutional as abridging the freedom of speech protected under the Fourteenth Amendment of the Constitution of the United States.

The Arizona Supreme Court reversed the order for the temporary injunction because the lower court had relied, in deciding the case, exclusively on A.R.S. § 23-1322.

[1] 84 Ariz. 120, 324 P.2d 1002 (1958). See also CONSTITUTIONAL LAW, *supra*.
[2] 82 Ariz. 385, 313 P.2d 759 (1957).

Municipal Corporations

Franklin Bridenhager

Interpretation of City Ordinance

The question presented in *Parrack v. City of Phoenix*[1] was whether the citizens of Phoenix had the authority to enact ordinances by initiative when the city council and mayor had the same power. The city charter granted both such powers.

This question was raised when the voters submitted an ordinance to the city council, which could pass it without alteration or could call a special election. The latter alternative was used, and the ordinance which raised the salaries of the city firemen was passed. But the officials of the city refused to heed such ordinance because they claimed that this power of initiative as granted in the charter conflicted with the mayor's and council's power.

In making permanent the mandamus compelling the city officials to abide by such ordinance, the Court relied upon the rule that if a city charter provides for different methods of expression, then these shall not affect or modify one another, but shall be accumulative, selective, and effective.[2] Such charter is to be read as a whole and its various provisions harmonized as far as possible.[3] Since, in the principal case, the authority to act was not exclusively conferred upon the city manager and governing body of the city, and there was no preliminary duty impossible of performance by the people, such as the holding of meetings, etc., then it is entirely possible for the courts to harmonize these provisions. Also, where the people have the power of initiative then such provisions should be construed liberally in their favor.[4]

Taxation by City

In *The City of Phoenix v. The Borden Company*[5] the sole question presented was whether the Borden Company in computing its tax base for the privilege license tax must include retail sales made beyond the

[1] 84 Ariz. 382, 329 P.2d 1103 (1958).
[2] City of Phoenix v. Yates, 69 Ariz. 68, 208 P.2d 1147 (1949).
[3] Glass v. Smith, 150 Tex. 632, 244 S.W.2d 645 (1951).
[4] *Ibid.*
[5] 84 Ariz. 250, 326 P.2d 841 (1958). See also TAXATION, *infra*.

corporate limits of the city. Although in this case the Court by construing the ordinance held that the retail sales outside the city should not be included in computing the tax, by dicta the Court implied that it could be done under a properly drawn ordinance. Even though there is a presumption that the governing body of the city was legislating with reference to the conduct of business within the territorial limits of the city,[6] and even though tax statutes will be most strongly construed against the taxing authority and in favor of the taxpayer, it is certainly possible to tax the company on the basis of sales inside and outside the city limits. Justice Phelps in the dissenting opinion felt the emphasis should be placed upon the fact that the license was for the privilege of doing business, and since everything except the sale was consummated within the city, then it would make no difference where the sale itself took place. Some ordinances have been given such a construction.[7]

Right of Taxpayer to Challenge City Expenditures

Does a taxpayer have an unqualified right to intervene in a suit which was commenced at his request to challenge an expenditure authorized by the mayor and city council? In *Mitchell v. The City of Nogales*,[8] the Court said "no" to this question . The mayor and city council adopted an authorization for the report and survey of electric and gas services. The plaintiff, a taxpayer, availed himself of the appropriate provision of the city charter and demanded of the city attorney that this be enjoined. The issues which the taxpayer sought to raise in his intervention were identical to those raised by the city attorney. It was held that where the city attorney of a municipal corporation commences a proceeding at the request of a taxpayer against certain city officials, and the court finds that he is proceeding with due diligence, the court may in the exercise of sound judicial discretion refuse to allow the taxpayer to become a party to such action.[9]

The reasons for not allowing a permissive intervention are twofold.[10] First, before a citizen may maintain such an action, it must be shown that the one who had a primary right to bring the suit has refused to do so. Second, the great possibility of purely vexatious law suits which would permit one who is not vested with duties or discretion in such matters to substitute his judgment and discretion for that of those to whom the law has confided them.

[6] Ferguson v. Shell Petroleum Corporation, 81 F.2d 193 (8th Cir. 1936).
[7] Arizona State Tax Commission v. Ensign, 75 Ariz. 220, 254 P.2d 1029 (1953); Arizona State Tax Commission v. Quebedeaux Chevrolet, 71 Ariz. 280, 226 P.2d 549 (1951).
[8] 83 Ariz. 328, 320 P.2d 955 (1958).
[9] See City of Cincinnati v. Kellogg, 153 Ohio St. 291, 91 N.E. 2d 505 (1950).
[10] Williams v. Stallard, 185 Ky. 10, 213 S.W. 197 (1919).

Power of Legislature to Modify Pension Statutes

In *Police Pension Board for the City of Tucson v. Denny,*[11] the Court considered whether the legislature could lawfully amend the Police Pension Act of 1937 so as to deprive the plaintiff of his pension payments during employment in any other capacity by a governmental unit. In reversing the trial judge, the Arizona Supreme Court answered this in the affirmative.

In 1933 the plaintiff became a member of the police department. In 1937 the legislature adopted a pension plan which provided monthly payments equal to one-half of the employee's average salary. The act was amended in 1952 by the legislature providing for suspension of the pension while the pensioner is employed by the state, county, or a municipality.[12] After receiving his pension the plaintiff entered into employment with the county, and consequently the board suspended his pension payments. The plaintiff argued that the 1952 amendment was unconstitutional as applied to him because the contractual right under the 1937 act had became vested and could not be abrogated by subsequent legislation. Upon this matter the courts generally are in conflict, and it being one of first impression here, the Court applied its own view. While it is difficult to accurately describe the nature of the relationship between plaintiff and the city, it would appear to be in the realm of quasi-contract, with a certain right being given to the officer that must be respected, subject to reasonable modification. The courts are fairly well in agreement in permitting, prior to retirement, reasonable legislative modification of pensions as the plans must be kept flexible to permit adjustment in accordance with changing conditions, and at the same time maintain the integrity of the system and carry out its beneficient policy.[13] Whether a particular modification of a pension plan is reasonable is for the courts to determine upon the facts of each case.[14] But upon the issue of reasonableness of foundation for classification contained in the statute, if the court is in doubt as to whether a reasonable basis therefore exists, the doubt will be resolved in favor of the constitutionality of the law.[15]

[11] 84 Ariz. 394, 330 P.2d 1 (1958). See also CONSTITUTIONAL LAW, *supra.*
[12] A.R.S. § 9-928: "Effect of Service as Public Officer upon Pension. A. A person who has been retired from service under the provisions of this article and awarded compensation in accordance therewith, and who after retirement receives a salary as an officer or employee of the state, county or municipality, shall forfeit and shall not receive at any time compensation for the period during which he receives a salary as such officer or employee, but upon termination of service as such officer or employee all the rights of the pension, other than the right to receive compensation for the period after retirement during which he receives a salary as an officer or employee of the state, county or municipality, shall be recognized."
[13] Kern v. City of Long Beach, 29 Cal.2d 848, 179 P.2d 799 (1947).
[14] Allen v. City of Long Beach, 45 Cal.2d 128, 287 P.2d 765 (1955).
[15] Schrey v. Allison Steel Mfg. Co., 75 Ariz. 282, 255 P.2d 604 (1953).

Challenge of Board of Supervisor's Orders

The last case regarding municipal corporations decided in Arizona was *Wahl v. Hart.*[16] The appellants brought an action to set aside an order of the Board of Supervisors of the county creating an improvement district. By statute,[17] improvement districts may be organized in areas without incorporated cities. The question involved was the sufficiency of publication and standing to raise the question of such sufficiency. The Court held that where the sufficiency of the notice of the meeting creating the district is in issue, a party ought not to be required to attend the meeting and raise the objection before he may take advantage of the statute and appeal.[18] Were it otherwise, one who did not have knowledge of the meeting by reason of lack of notice would never be able to present the question in court simply because he never had the opportunity to be heard by the Board.

[16] 85 Ariz. 85, 332 P.2d 195 (1958). See also COURTS AND PROCEDURE, *supra.*

[17] A.R.S. §§ 11-701 to 11-758.

[18] A.R.S. § 11-707: "Review of Action of Supervisors. Any party aggrieved by an act of the board of supervisors in the establishment of an improvement district may bring an action in the superior court of the county in which the district is located to set aside the action of the board, not later than twenty days after final determination by the board."

Partnership

GERALD RABY

Joint Adventure

The existence of a joint adventure was the question raised by interpleader proceedings in *Arizona Public Service Company v. Lamb.*[1]

The stakeholder was a ginning company claiming no interest in the balance of a grower's account which creditors were attempting to reach.

The fact that the growers (two brothers with independent farming operations) secured a crop loan jointly and issued orders on a joint account with the ginning company did not make them joint adventurers. The Court found neither a joint operation nor a venture for share in profits.[2] Therefore, creditors of the bankrupt brother (Joe Lamb) could not enforce their claims against the appellee (Ed Lamb).

The trial court had allowed the stakeholder the sum of $509.65 as costs of interpleading and had deducted this amount from the share due one claimant. The Supreme Court stated that this would be giving a preference which was unwarranted. Inasmuch as the sum was insufficient to satisfy all claimants, the Court held that they would have to share on a pro rata basis the amount remaining after deduction of the costs allowed the stakeholder.

[1] 84 Ariz. 314, 327 P.2d 998 (1958).

[2] "We have said a joint adventure is a special combination of two or more persons where in some special venture a profit is jointly sought, Ruby v. United Sugar Companies, S.A., 56 Ariz. 535, 109 P.2d 845 (1941), and that under all the authorities a share in the profits is necessary to create such a venture, Estrella v. Suarez, 60 Ariz. 187, 134 P.2d 167 (1943)." Arizona Public Service Company v. Lamb, Ibid.

Property

L. ALTON RIGGS JR.

Eminent Domain

An interesting application of the Arizona Constitution, Article 2, Section 17, to § 59-601 A.C.A., (now A.R.S. §§ 18-201—18-205) was made in *Pima County v. Nick Cappony.*[1] Where the board of supervisors awarded plaintiff $1,250.00 damages for removing certain improvements but made no award for the value of the property taken according to the power invested in the board by the legislature, plaintiffs had due notice of the proceedings but did not accept the award and instituted this action. Trial resulted in a judgment in the sum of $2,050.00 as compensation for property taken and $3,000.00 severance damages. The Supreme Court of Arizona held that the plaintiffs were not bound by the board's action. The Court voiced the opinion that the constitution states what an owner's rights are when private property is to be taken or damaged for public use. It prescribes that the owner shall have just compensation and the same shall be ascertained by the jury (unless waived) as in other civil cases in courts of record in the manner prescribed by law. In harmony with this constitutional mandate, § 27-909, A.C.A. 1939 (now A.R.S. § 12-1116) requires that all proceedings for condemnation must be brought in the superior court in the same manner as other civil actions. Thus to the extent that § 59-601, A.C.A. 1939 purports to empower the board to assess compensation or damages, it offends the Arizona Constitution, Article 2, Section 17, and cannot be given validity.

A similar holding is found in *State v. Leeson*[2] where the Court held that flooding of land is compensable under eminent domain provisions.

In *State v. Carlson*[3] the Arizona Supreme Court affirmed the trial court's allowance to lessees for loss of their building space through condemnation. The allowance consisted of damages for reduction in rented space to the end of the period of the existing lease, expenses incurred in removing, rearranging, and reconnecting fixtures, and damages to the leasehold interest for lease renewal option for two years, in the amount

[1] 83 Ariz. 348, 321 P.2d 1015 (1958). See also CONSTITUTIONAL LAW, *supra.*
[2] 84 Ariz. 44, 323 P.2d 693 (1958).
[3] 83 Ariz. 363, 321 P.2d 1025 (1958).

of $490.00. The Court held that a lessee is entitled to a sum which will adequately compensate him for his pecuniary loss as a result of the exercise of the power of eminent domain and is entitled to the value of an option of renewal in addition to the value of the unexpired term of the lease.

Where the state condemns only a part of the leasehold, the measure of damage is the difference between the value of the remainder before and after the taking. The Court recognized that there is no certain and exact rule for measuring damages where an option to renew a lease is impaired or diminished in value due to a condemner taking a portion of a leasehold, as in each case variable factors must be considered. However, there was sufficient evidence from which the trial court could mathematically compute the difference between the value of the remainder before and after the taking and determine the damages sustained. The Court further stated that it was reasonable to assume that a lessee with a successful business would continue to operate and thus the allowance of damage for the short-term renewal period was properly held not to be speculative.

County of Maricopa v. Shell Oil Company[4] reaffirms the rule of the *Carlson* case, *supra, i.e.*, when only a part of the property is taken, the measure of severance damages is the difference between the market value of the property not taken, before and after the taking.

Adverse Possession

The trial court was reversed in *Guenther and Shirley Co. v. The Presbytery of Los Angeles, et. al.*[5] Following the case of *Trevillian v. Rais,*[6] and various persuasive rulings from other jurisdictions, including: *Little Red River Levee District No. 2 v. Thomas,*[7] *Hastings v. Montgomery,*[8] *Murphy v. Seward,*[9] and *Abates v. Timbes,*[10] the Court determined that one who enters and takes possession of another's property under and in reliance upon a certificate of tax sale can initiate adverse possession under A.R.S. § 12-526.

In line with the above mentioned cases, the Court stated that the statutes of Arizona upon the subject of tax sales contain no provision with reference to the right of possession during the period of redemption, and a purchaser of a tax sale certificate has a lien only and does not have the right to possession. Since a tax sale certificate is only evidence which

[4] 84 Ariz. 325, 327 P.2d 1005 (1958). See also EVIDENCE, *supra*.
[5] 85 Ariz. 56, 331 P.2d 257 (1958).
[6] 40 Ariz. 42, 9 P.2d 402 (1932).
[7] 154 Ark. 328, 242 S.W. 552 (1922).
[8] 142 Okla. 47, 285 Pac. 89 (1929).
[9] 145 Miss. 713, 110 So. 790 (1926).
[10] 214 Ala. 591, 108 So. 534 (1926).

entitles the holder to a deed upon the happening of certain conditions, such holder has no right to possession until expiration of the redemption period. If he enters without the owner's consent, he is a trespasser, and from that moment a cause of action against him accrues, for his possession is a hostile, actual, visible apppropriation of the land, commenced and continued under a claim of right inconsistent with the claim of another and fulfills the requirements designated in A.R.S. § 12-521.

In *Joseph D. Cannon v. Arizona Game and Fish Commission, ex. rel. The Attorney General,*[11] the Supreme Court of Arizona affirmed the judgment against Cannon for contempt of court. Cannon forcibly entered leased land of M. E. Smiley Farms, Inc. and Arizona Game and Fish Commission. He then cut and removed trees and operated and excavated with heavy equipment thereon. After being issued a writ of restitution by the sheriff he subsequently re-entered the premises in callous disrespect of the orders of the court. The trial court issued a second order to show cause why he should not be punished for contempt. The significance of the case as relates to property law is that if the defendant who once has been convicted of forcible entry and detainer, subsequently acquires title or a right of possession to the property involved superior to the plaintiff's, he may file an independent action in the superior court of the county and establish such superior right of possession; but until he does so, he is bound to abide by the judgment in forcible entry and detainer.

Public Lands

Is the failure to verify a statement of equities filed with the Land Commissioner sufficient to preclude one's equities in land from being considered by the Commissioner? *Montierth v. State Land Department,*[12] answers this question in the negative. In this case the Supreme Court of Arizona affirmed the trial court which awarded a lease to Sparks, an applicant, who failed to verify a statement of equities, but who offered testimony that his cattle had run over the area for 30 years, had grazed there 20 years, and said area was within his fence enclosure. By dictum the Court added, even total failure to submit a statement does not preclude the Commissioner from proceeding to make his determination upon whatever record and testimony is available.

[11] 85 Ariz. 1, 330 P.2d 501 (1958).
[12] 84 Ariz. 100, 324 P.2d 228 (1958).

Sales

Philip Toci

Breach of Warranty

Isenberg v. Lemon[1] concerned the question of damages recoverable for breach of warranty. Plaintiff was in the business of supplying painting contractors with housepaint and had several oral contracts to supply rubberized paint of a certain color, grade, and quality. Defendant was a paint distributor from whom plaintiff had been purchasing a rubberized paint called "Tempolite" which he and the contractors had found to be satisfactory. Defendant decided to manufacture his own paint and persuaded plaintiff to purchase it, rather than "Tempolite," and "guaranteed" that the new paint would be equal in quality to "Tempolite" in every respect.

The evidence showed that the new paint was worthless and that as a result the contractors had all cancelled their agreements with the plaintiff. The trial court awarded plaintiff damages based on loss of profits and loss of good will.

The Supreme Court stated that the general rule on damages for breach of warranty permits recovery only for the difference between the value of the goods at the time of delivery and the value which they would have had if they had been as warranted.[2] However, since the defendant here knew the purpose for which plaintiff bought the paint and was aware of the unusual damages which could result from the breach, "under all of the authorities," the Court said, recovery may be had for loss of profits and good will if the complaint is amended to encompass such loss.

Damages resulting from loss of good will need not be proved with mathematical precision and the trial court properly awarded them in the instant case. However, the Court said, loss of profits may be proved with at least "an approximation of mathematical precision" and a new trial should be awarded on this question, since the plaintiff neither alleged nor proved loss of profits.

On rehearing,[3] the Court revised its former opinion and held that the loss of profits could be shown without amending the complaint but

[1] 84 Ariz. 340, 327 P.2d 1016 (1958).
[2] Uniform Sales Act, A.R.S. § 44-269(G).
[3] Isenberg v. Lemon, 84 Ariz. 364, 329 P.2d 882 (1958).

that the evidence was still insufficient to sustain the loss found by the trial court.

Ellen v. Maricopa County[4] was an action brought by the county to recover the purchase price on a vitamin mixture sold it by the defendant. Plaintiff apparently relied on defendant's warranty that the mixture was the product of a named company as was specified in the defendant's bid. Judgment for the plaintiff was reversed on the ground that the evidence did not support a finding that the mixture was not manufactured as warranted.

Risk of Loss

Whether the risk of loss fell on the seller or the buyer in a contract for sale of a one-half interest in the license, equipment, and inventory of a tavern was the issue raised in *Levandoski v. Pacheco.*[5] The parties entered into a written agreement which recited in part, "I, J. E. Levandoski am selling my half interest in the . . . Tavern . . . to Marcus E. Pacheco . . . . If transfer is not approved half of profits in wages be turned to me J. E. Levandoski."

Plaintiff (buyer) paid most of the purchase price at the time the agreement was made, and the balance two or three days later. Subsequently, the transfer of the license was disapproved. The parties had agreed orally that the sale would be void in the event the transfer was not approved. Hence, plaintiff sued to recover the purchase price. Defendant contended that the risk of loss was on the plaintiff under the provisions of the Uniform Sales Act, A.R.S. § 44-222, which provides that when the property "is transferred to the buyer the goods are at the buyer's risk whether delivery has been made or not." The risk of loss was on the plaintiff, argued the defendant, and no recovery could be had unless plaintiff first returned or offered to return the goods. Since the goods had been stolen or destroyed by vandals the plaintiff could not recover if this theory were accepted.

The Supreme Court affirmed the judgment for plaintiff in the trial court. Defendant's contention was rejected, the Court saying that even though the provision of the contract relating to the "turn" of profits to the seller, in the event of disapproval of the license transfer, could be construed as indicative of an intention to transfer *possession,* that it did not require such a construction. The Court also said,

> It is reasonable to believe that the parties intended for the transaction to be final as of the date of the approval by the Super-

[4] 83 Ariz. 359, 321 P.2d 1023 (1958).
[5] 84 Ariz. 55, 323 P.2d 951 (1958).

intendent and that they further intended for the ultimate transfer of interest to then occur. Since the trial court could have found that there was no transfer of possession, or intention to transfer, the loss was appellant's and not appellee's.

The evidence indicated that the plaintiff did not actually take possession of the tavern before the liquor license was disapproved and one witness testified that the defendant "was there." It is not clear whether the Court regarded a transfer of possession as a requisite to the transfer of the property in the goods or whether it was merely regarded as evidence to establish the intent to transfer the property.

Retention of possession by the seller is generally not regarded as any evidence of an intention by the seller to *retain* the property in the goods in light of the unequivocal language of the Uniform Sales Act, A.R.S. § 44-219 (1).[6] However, language in some prior Arizona decisions would indicate a contrary view.[7] Though delivery of possession is strong evidence of an intention to *pass* title it is not usually a requisite thereto unless the parties have so agreed.[8]

On the other hand, where the intentions of the parties are not clear, a number of well-settled presumptions are applied to determine their intentions.[9] One of these is that the property is presumed to pass when the contract is made if the subject of the sale is identified and nothing remains to be done other than delivery of the goods and the payment of the price.[10] Also, payment of the whole price or of a considerable part of it is evidence of an intention to make an immediate transfer, since it is not very common for buyers to pay in advance.[11]

Conditional Sales

The question of whether the vendor of a car under a conditional sales contract could reclaim it from a bona-fide purchaser arose in *Dissing v. Jones.*[12] Plaintiff, an Oklahoma car dealer, sold a car to one Moore under a conditional sales contract without complying with the

[6] Uniform Sales Act, A.R.S. § 44-219 (1) provides: "Where there is an unconditional contract to sell specific goods, in a deliverable state, the property in the goods passes to the buyer when the contract is made and it is immaterial whether the time of payment, or the time of delivery, or both, be postponed." (The rule applies to conditional contracts also. It has even been held to apply to technical conditional sales though it was not so intended. See Thomas J. Jewett, Jr., Inc. v. Keystone Driller Co., 185 N.E. 369, 87 A.L.R. 1298 (Mass).

[7] *E.g.*, Stephens-Franklin Motors v. Lambros, 71 Ariz. 389, 228 P.2d 267 (1951).

[8] Vold, Sales, 131-133 (1931).

[9] 2 Williston, Sales, § 263 (1948).

[10] 2 Williston, *op. cit. supra* § 264.

[11] 2 Williston, *op. cit. supra* § 265.

[12] 85 Ariz. 139, 333 P.2d 725 (1958).

Oklahoma statute requiring all liens to be stated on the back of the certificate of title. On the basis of this certificate Moore had an Oklahoma certificate of title issued to him reciting that the car was free of liens. Moore then came to Arizona and sold the car to the defendant. The trial court held that plaintiffs were estopped to assert paramount title against the defendant. In affirming the trial court, it was said that the plaintiff was estopped to claim ownership of the car for two reasons: (1) the plaintiff seller had clothed the third party, Moore, with the indicia of complete ownership, and (2) where one of two innocent parties must suffer from the act of a third, the loss must be borne by him whose act or omission made the loss possible.

In the words of the Court, "If the plaintiffs had listed the conditional sales contract in the space provided therefor when the assignment was made to the purchaser, undoubtedly the same would have been reflected on the Oklahoma certificate of title. The defendant would not have purchased the car and no loss would have resulted."

Plaintiffs relied on *Ragner v. GMAC*[13] to the effect that an encumbrance on personal property valid in the state where property is located is valid when secretly removed to this state. The Court said that this decision was not in conflict with the *Ragner* case because there was no element of estoppel involved in the latter.

[13] 66 Ariz. 157, 185 P.2d 525 (1947).

Taxation

MARVIN FORTMAN

Overassessments

In *Sparks v. McCluskey,*[1] the issue was whether an intentional over-assessment of the plaintiff's lands as compared to other lands within the county, although made in good faith as a long term program to bring to date all evaluations, could be placed in the category of illegal assessments because of their discriminatory character.

There was evidence that the plaintiff's assessed valuations showed varied increases of 300 to 600 percent over the previous year. It was also found that the assumed value of properties of a like class in the county were not proportionately increased, but their assessed values from the previous year were merely carried forward.

The assessor's contention was that the discrepancy was the result of a long term program to bring to date all valuations in Maricopa County. The evidence did not indicate how many years might elapse before the program would be complete and equalization effected.

It was held that if the result of intentional acts by the assessor is discriminatory, the assessments cannot stand regardless of his good faith. The Court said it could not approve of grossly unequal evaluations for an indefinite number of years until the taxing officials could get around to using the same method of evaluation on other like properties.

Taxation by City

City of Phoenix v. Borden Company,[2] involved the interpretation of a Phoenix ordinance.[3]

The Borden Company maintained a processing plant within the corporate limits of Phoenix and retailed its products both within and without the corporate limits. The Borden Company brought this action against the City of Phoenix to determine whether in computing its tax

[1] 84 Ariz. 283, 327 P.2d 295 (1958). See also EVIDENCE, *supra.*

[2] 84 Ariz. 250, 326 P.2d 841 (1958). See also MUNICIPAL CORPORATIONS, *supra.*

[3] Phoenix City Ord., No. G-93, § 2 (imposes a privilege tax on the gross proceeds of sales of every person selling any tangible personal property whatsoever at retail, except bonds and stocks).

base for the privilege license tax[4] it must include retail sales made outside the corporate limits of the City of Phoenix. The Court held that the tax should be computed only on the retail sales made within the city limits.

It was felt that the Phoenix City Council could have measured the tax based upon the gross amount of goods or products manufactured or processed within the corporate limits as they did in another paragraph of this ordinance. The Court reasoned that if the legislative body had intended to compute the tax on gross retail sales of all personal property, the provisions of the applicable paragraph would have so stated as the paragraph relating to meat products did. However, the legislators must have intended a distinction, and therefore, the Court would not reconstruct the language of the ordinance to give it that effect.

In a dissent by Justice Phelps, he concluded that the ordinance was clearly meant to tax retail sales of tangible personal property sold by firms doing business in Phoenix, whether or not the retail sale occurred within or without the city limits, as the taxable incident is the engaging in business in Phoenix.

Mining Tax

The power of the State Tax Commission to assess both a mining tax and retail tax on brick manufacturers was challenged in *State Tax Commission v. Wallapai Brick and Clay.*[5]

The plaintiffs were brick manufacturing companies who were engaged in the business of removing clay from the ground, forming it into brick and selling it to contractors. They contended that the making of brick after the initial removal of the clay from the ground was manufacturing, and therefore exempted from the purview of A.R.S. § 42-1310.[6] They also contended that because of A.R.S. § 42-1321(3) which exempts sales of tangible personal property when sold to a person licensed as a contractor, they were also exempt from the retail sales tax imposed by A.R.S. § 42-1312.[7] The commissioner's position was that the taxing statutes should be interpreted as imposing upon the operation of the plaintiff's businesses both the mining tax and the sales tax.

[4] *Ibid.*
[5] 85 Ariz. 23, 330 P.2d 988 (1958).
[6] A.R.S. § 42-1310 subdivision (a) of par. 2 (imposed a tax on the gross proceeds of sales from any business engaged in the mining, quarrying or producing of any mineral product for sale, profit or commercial use).
[7] A.R.S. § 42-1312 (levies a retail sales tax on the sale of tangible personal property).

In rejecting the plaintiffs' first contention, the Court held that the legislature had not exempted all forms of manufacturing from the application of A.R.S. § 42-1310, and the removal of clay from the earth's surface and the fabrication thereof into finished bricks was a business within the provisions of this statute.[8] On the second question the Court held the plaintiffs were entitled to be exempt from the retail sales tax as the legislature did not intend to tax any income of a person more than once.[9]

Taxation of Sales to United States

The sole question presented in *State Tax Commission v. Al Stovall Manganese*[10] was whether or not sales of ore made to the United States government may be taxed by the State of Arizona. The Court held that under § 73-1308, A.C.A. 1939 which was in effect when the sale was made, a sale of tangible personal property to the United States government was not taxable under the statute.

Note: § 73-1308, A.C.A. 1939 was repealed.[11] It seems clear from the enactment which repealed it that sales of tangible personal property by persons engaged in businesses covered in the revised statute will now be taxed upon the value of the entire product mined, quarried, produced or prepared for sale even though it is sold to the United States government or its agencies.[12]

[8] The Court reasoned that since A.R.S. § 42-1311 referred to manufacturing and it modified A.R.S. § 42-1310, A.R.S. § 42-1310 did include a business whose income was derived from manufacturing.

[9] Crane Co. v. Arizona State Tax Commission, 63 Ariz. 426, 163 P.2d 656, 659; 163 A.L.R. 261 (1945). (Those engaged in mining, timbering, etc., are not taxable on a retail sale basis.)

[10] 84 Ariz. 333, 327 P.2d 1011 (1958).

[11] Sec. 15, ch. 136, L. '54.

[12] A.R.S. § 42-1310(2)(a).

Torts

Richard Keefe

Attractive Nuisance

In *MacNeil v. Perkins*[1] the plaintiffs, three boys, 11, 13, and 16 years of age were injured while attempting to ignite some dynamite caps which they had taken from a powder magazine on the defendant's land. The Supreme Court sustained the trial court's instruction on the attractive nuisance doctrine and adopted the view of the *Restatement of Torts.*[2] The judgment for plaintiffs against both the defendant land owners and their caretaker was affirmed.

There is considerable authority to the effect that the doctrine of attractive nuisance is not applicable to a child over the age of 14 who has not been found incompetent.[3] However, the Arizona Supreme Court felt that the question of whether the plaintiffs understood the dangerous nature of the dynamite caps was properly given to the jury.

Wrongful Embalming

Damages were sought for embalming without express permission in *Hale v. Brown.*[4] Plaintiff's husband died while at work and plaintiff was denied recovery by the Industrial Commission.[5] The deceased's body was taken to the defendant undertaker, and he embalmed it before a complete autopsy was performed. The plaintiff alleged that the unauthorized embalming prevented a determination of whether the cause of death was gas poisoning, and hence plaintiff was unable to obtain benefits under the Workmen's Compensation Act. On appeal from a summary judgment for defendants, the Court sustained the trial court as the uncontroverted medical evidence showed that embalming would not prevent a determination that the cause of death was due to gas

[1] 84 Ariz. 74, 324 P.2d 211 (1958). See also ATTRACTION AS ELEMENT OF ATTRACTIVE NUISANCE DOCTRINE, *infra.*

[2] Restatement, Torts, § 339 (1934). The unqualified adoption of the Restatement view seems to overrule Salt River Valley Water Users' Association v. Compton, 39 Ariz. 491, 8 P.2d 249 (1932) insofar as that case required that the child be attracted to the defendant's land by the instrumentality which injured him.

[3] 65 C.J.S. Negligence, § 29(11) at 469 (1950); Belt Railroad Co. v. Charters, 123 Ill. App. 322 (1905); Pollard v. Oklahoma City Railroad Co., 36 Okla. 96, 128 Pac. 300 (1912); Abbott v. Alabama Power Co., 214 Ala. 281, 107 So. 811 (1926).

[4] 84 Ariz. 61, 323 P.2d 955 (1958). See also COURTS AND PROCEDURE, supra.

[5] Hale's Estate v. Industrial Commission, 78 Ariz. 202, 277 P.2d. 1014 (1955).

poisoning, and since no damages were sustained from the embalming, the summary judgments were properly granted.

Two judges dissented on the theory that embalming without authority would sustain an action for at least nominal damages and since there was some question whether there was or was not authority to embalm, the question should have been given to the jury.

Fraud

In *Mayo v. Ephrom*[6] and *Sult v. Bolenbach*[7] the Court was confronted with almost identical situations. In each case the seller of land misrepresented the capacity of a well on his land to induce the purchaser to buy the land. Both sellers contended that where the purchaser undertakes an independent investigation the seller is released from liability for representations. The Supreme Court held that where a person performs only a partial investigation and still relies in part upon the representations of the adverse party and is thereby deceived, a cause of action will lie, and there was sufficient evidence from which the jury could find this to be the case.

The Court was confronted with the problem of fraud based on an opinion rendered by an attorney to a mentally incompetent client in *Lietz v. Primock.*[8] The Court held that the relationship of attorney and client creates an exception to the general rule and permits statements of opinion to serve as a basis for actionable fraud, where such opinion is tainted with an intent to gain some advantage over the client, either for himself or for another party.

Governmental Immunity

The sometimes harsh result that occurs when a person is denied recourse under the doctrine of governmental immunity is strikingly illustrated in *Lee v. Dunklee.*[9] The plaintiff's infant son died as a result of the negligence of an employee of the defendant, while the infant was being treated in the county hospital. The trial court sustained defendant's motion to dismiss and the Arizona Supreme Court affirmed solely on the ground of governmental immunity. The Court rejected plaintiff's contention that since the hospital admitted and treated both indigent and paying patients, and since the county was under no mandatory duty to maintain the hospital, the doctrine of governmental immunity did not apply.

[6] 84 Ariz. 169, 325 P.2d 814 (1958). See also COURTS AND PROCEDURE, *supra.*
[7] 84 Ariz. 351, 327 P.2d 1023 (1958). See also COURTS AND PROCEDURE, *supra.*
[8] 84 Ariz. 273, 327 P.2d 288 (1958). See also ATTORNEY AND CLIENT, *supra.*
[9] 84 Ariz. 260, 326 P.2d 1117 (1958).

The Court conceded the harshness of the result and indicated a need for re-examination of the doctrine, but felt that any modification of what it considered the majority rule should be left to the legislature.

Last Clear Chance

In *Southern Pacific Co. v. Cavallo*[10] the Court after a careful analysis of the facts decided that the trial court's instruction on last clear chance was error. The Court found that if the plaintiff had not reduced his speed upon learning of his peril, he would have traveled beyond the train crossing before the train arrived. Thus it was decided that plaintiff was not in a position of peril from which he could not extricate himself, and last clear chance did not apply. The sufficiency of warning signs to indicate the existence of the railroad crossing was also considered by the Court, and it found that under the circumstances the plaintiff had adequate warning of the crossing.

In addition to the above the plaintiff also predicated his claim on the negligence of the defendant's employees in failing to give adequate warning of the approach of the train, and the Court felt that the failure to give such warning would amount to actionable negligence. However, since it was not clear on which basis the jury returned a verdict for plaintiff, the case was remanded for a new trial.

Malicious Prosecution and False Imprisonment

Wisniski v. Ong[11] was an action against a store owner and his employee for malicious prosecution and false imprisonment. The defendants had signed a criminal complaint charging plaintiff with theft, as one of the defendants claimed to have seen plaintiff take a box of pills without having paid for it. Plaintiff, in the civil action, alleged that she had purchased the pills elsewhere prior to entering the defendant's store. The jury found for the plaintiff and the defendants' motion for judgment n.o.v. was granted. Plaintiff, on appeal, contended that since she was ultimately acquitted in the criminal action, as a matter of law there was want of probable cause for prosecution.

The Court held that while the lack of probable cause for malicious prosecution is ordinarily a question for the court alone, where there is a conflict in the evidence it is for the jury to determine. Since the jury must have found that the plaintiff did not steal the pills they impliedly found that plaintiff could not have been seen taking them. Thus the subsequent prosecution for theft was maliciously instigated and without

[10] 84 Ariz. 24, 323 P.2d 1 (1958). See also EVIDENCE, *supra*.
[11] 84 Ariz. 372, 326 P.2d 1097 (1958).

probable cause. The Court rejected defendants' claim that because they signed the complaint on the advice of the assistant city attorney probable cause existed as a matter of law. It was held that such a defense was valid only if there was a showing of full disclosure of all the facts to the attorney, and as the defense was an affirmative one, the burden of proof was on the defendants and had not been sustained.

As to the claim of false imprisonment the Court held that the plaintiff by her own testimony had precluded a finding of imprisonment as she testified that at no time was she afraid to leave the store.

It should be noted that recent additions to the criminal code[12] cover arrest on suspicion of shop lifting and may possibly alter the future results of cases similar to the *Wisniski* case.

Negligence, Contributory Negligence & Negligence Per Se

In *Gray v. Woods*,[13] immediately prior to the collision with defendant's truck, the car in which the decedent had been riding was stopped crosswise directly in the defendant's line of traffic. The accident occurred at night as the defendant was negotiating a mountain incline. Prior to the accident the defendant had dimmed his lights to signal another car to pass; the lights were on dim at the moment of impact. The evidence indicated that there was straight and unobscured vision 540 feet prior to the point of impact, and that the defendant could see approximately 175 feet with his dim lights and could have seen over 1000 feet with his bright lights. An Arizona statute[14] requires that a person driving at night use light of a sufficient intensity to reveal persons or vehicles for a safe distance in advance of the vehicle.

In an action for wrongful death, the trial court granted an instruction based on unavoidable accident. The Supreme Court in reversing and remanding followed a recent Arizona decision,[15] and held that such an instruction was error inasmuch as there was no evidence tending to show that the death of the decedent resulted from any cause other than the negligence of someone. The Court affirmed the lower court's holding that the defendant's driving while on dim beams did not constitute negligence per se, but was a jury question. The Court also held that the plaintiff was entitled to an instruction on last clear chance under the circumstances of the case.

In *Larsen v. Arizona Brewing Co.*[16] the plaintiff alleged that the defendant was negligent in failing to properly warn persons traveling

[12] A.R.S. §§ 13-673 to 75.
[13] 84 Ariz. 87, 324 P.2d 220 (1958). See also EVIDENCE, *supra*.
[14] A.R.S. § 28-942.
[15] Town & Country Securities Co. v. Plas, 79 Ariz. 122, 285 P.2d 165 (1955).
[16] 84 Ariz. 191, 325 P.2d 829 (1958). See also AGENCY, *supra*.

on an arterial highway of a crossing used by defendant while resurfacing a section of the highway under a contract with the state. The collision occurred five miles from the site of the resurfacing job.

The contract between the state and the defendant required that warning devices be placed only in the areas where the actual work of resurfacing was being done. Thus, the Supreme Court found that there was no duty to warn the plaintiff at the point where the accident occurred. The evidence also established that a warning sign was posted by defendants 300 feet from the intersection where the accident happened, and the Court decided that as a matter of law this constituted adequate warning to the plaintiff.

The Court held in *Smith v. Gates*[17] that the mere fact that the mechanical hand signal on defendant's truck was in the left turn position after an accident does not conclusively prove that the signal was given continuously for 100 feet prior to making the turn, as required by statute.[18] The trial court was therefore justified in finding the defendant guilty of negligence in making a left hand turn across the center of the highway.

The question of the duty owed to an invitee was presented in *M.G.A. Theaters v. Montgomery*.[19] The plaintiff, a patron at defendant's drive-in-theater, was injured when run over by a car driven by another patron as she sat on the ramp in front of her car watching the movie. The trial court, with the Supreme Court affirming, found the defendant proprietor liable by holding that the defendant owed to the plaintiff the duty of maintaining in a reasonably safe condition that part of its premises occupied by the plaintiff as an invitee, and there was sufficient evidence from which a jury could find defendant had not done so.

The Court also noted that where a proprietor knows, or in the exercise of ordinary care should know that his patrons are using an area not as originally intended, he extends an implied invitation for such use.

In *Beliak v. Plants*[20] the Arizona Supreme Court reversed the trial court for giving an instruction to the jury to the effect that, "the driver of an automobile is not required to anticipate the sudden appearance of children in his pathway under ordinary circumstances." The plaintiff, a five-and-one-half year old boy, was playing in the middle of a dead-end street, and was injured when struck by defendant's car as defendant was backing from his driveway into the street. The Court held that the facts did not justify the above instruction as there was evidence tending to show that the defendant knew that small children sometimes played

[17] 84 Ariz. 270, 327 P.2d 94 (1958).
[18] A.R.S. § 28-754.
[19] 83 Ariz. 339, 321 P.2d 1009 (1958).
[20] 84 Ariz. 211, 326 P.2d 36 (1958). See also COURTS AND PROCEDURE, *supra*.

in the street, and under the circumstances reasonable care required the defendant to anticipate that children might suddenly get into the path of the automobile.

Possibly more significant than its holding is the dicta of the *Beliak* case. The Court stated that because of his tender years, the plaintiff is not legally responsible for his acts either of commission or omission, and therefore could not be guilty of contributory negligence. This raises by about a year the age at which a child is as a matter of law free from contributory negligence.[21] The age of the plaintiff was also held to justify an instruction that the driver of a car must exercise greater caution for the protection of a child than for an adult.

In *Wolfe v. Ornelas*[22] an instruction by the trial court based on a reduced speed statute[23] gave the impression to the jury that under all conditions (even as to a person traveling on a favored highway at a lawful rate of speed) speed must be appropriately reduced at intersections, otherwise it is a violation of statute and thus, negligence per se.

The Supreme Court reversed the decision based on the fact that the statute must be read in its entirety; therefore an instruction based on one subsection alone was insufficient. The Court held that the reduce-speed statute requires only that a motorist traveling on a favored highway reduce his speed when approaching an intersection if actual or potential hazards make it appropriate to do so and the question of whether or not it is appropriate, is for the jury. Hence, there can be no negligence per se until such time as it is found that the existing conditions warranted a reduction of speed.

In *Thompson v. Quandt*[24] the plaintiff, a pedestrian, though by statute given the right of way over vehicles, was found by the trial court to be guilty of contributory negligence for his failure to exercise reasonable care under the circumstances. The defendant, an operator of an auto, was attempting to make a left hand turn which would cross the plaintiff's path as he passed through the intersection from east to west. Evidence was presented to show that the plaintiff did not attempt to observe oncoming traffic.

In affirming the decision of the trial court in favor of the defendant, the Supreme Court held that the jury was warranted in finding the defendant not negligent in making his turn, as an emergency situation was thrust upon him by an approaching vehicle from the east, thus making it necessary to expedite his turn in order to avoid a collision with the other vehicle.

[21] De Amado v. Freedman, 11 Ariz. 56, 89 Pac. 588 (1902); Womack v. Preach, 64 Ariz. 61, 165 P.2d 657 (1946).
[22] 84 Ariz. 115, 324 P.2d 999 (1958).
[23] A.R.S. § 28-701.
[24] 83 Ariz. 343, 321 P.2d 1012 (1959).

Wrongful Death

The plaintiffs in *Baxter v. Harrison*[25] were the parents of the married decedent but were not his personal representatives. They attempted to bring an action for his wrongful death. The Supreme Court stated that where the deceased is married and owns personal property at the time of his death, an action for wrongful death may only be brought by the personal representative, or upon his failing to do so within 90 days after the accrual of the action, then by the surviving spouse.

[25] 83 Ariz. 354, 321 P.2d 1019 (1959). See also COURTS AND PROCEDURE, *supra*.

Trusts

Gary Keltner

The year 1958 saw but a single Arizona decision in the field of trusts and that decision was more notable in its implication than in its expression. The lone case was that of *Knight v. Rice*[1] in which a beneficiary of a trust was allowed to maintain an action for the recovery of trust proceeds which had erroneously been distributed to another beneficiary. The action was sustained in spite of the fact that the trust had, by written instrument, been terminated, and in spite of the fact that this same instrument purported to ratify all acts of the trustee and acknowledged the full satisfaction of all claims of the beneficiaries in the trust. The Court, however, did not discuss these matters in its opinion, the appeal being based solely on questions of estoppel.

The situation arose when, in 1939, Knight and Rice entered into an agreement for the purchase, subdivision, and sale of a certain tract of land. All proceeds of the enterprise were to be paid to a corporate trustee for distribution in accordance with an instrument of trust which was to be drawn. This instrument provided that the proceeds were, upon the joint and written authorization of both, to be distributed equally between Knight and Rice. This trust continued until 1949, at which time the trust was closed, the actions of the trustees ratified, and full satisfaction of all claims admitted. An accounting thereafter revealed that Knight had never been repaid certain advances with the result that Rice had received an overpayment of trust funds to the extent of $8587.03. Knight then brought this action for the recovery of the overpayment and, upon the trial, it was proven that Knight had at all times had access to the records of the venture, that his secretary had made entries in the books, knew of the discrepancy and had called it to the attention of Knight. It was concluded that Knight had, as early as 1945, realized that the books were not in order and yet had continued, throughout the remaining four years of the trust, to sign the written authorizations of equal distribution. It was further shown that upon termination of the trust Rice had invested the money received and that he had subsequently sold his investment, realizing an uncertain gain. Upon the basis of these facts the trial court held that Knight was estopped from making further claims against Rice. Upon appeal the Supreme Court reversed, pointing out that one of the essential elements of estoppel,

[1] 83 Ariz. 379, 321 P.2d 1037 (1958).

that of detrimental reliance, had not been established. Accordingly, the Court held that Rice had been unjustly enriched in the amount of $8587.03 and rendered judgment for Knight in that sum.

In the light of the foregoing decision, it therefore seems fair to conclude that the beneficiary of a trust may, in a proper case, be estopped to assert a claim thereunder.[2] As to the effect of the purported ratification and acknowledgment of full satisfaction, the issue remains in doubt, as the question was apparently not raised.

[2] This conclusion would seemingly be in accord with the general rule. "A beneficiary may be estopped . . . to assert claims under a trust." BOGERT, HANDBOOK OF THE LAW OF TRUSTS, (3rd ed. 1952), at 696.

Water Rights

BOB BALDOCK

Mullen v. Goss[1] was an action to quiet title to and restrain defendants from interfering with the plaintiff's right to use certain waters located on the public domain. The controversy arose as to the water from three springs to which the plaintiff claimed a prior right to appropriate, and also water from a well. The plaintiff's claim to the well water was apparently based on the theory of appropriation. The defendant's answer alleged a prior right of appropriation as to the spring waters, and an allegation that the well water was percolating and on his land and that he was therefore entitled to the exclusive enjoyment of it. The Court reversed, stating that the trial court's finding that the spring waters were percolating could not be sustained, despite some support in the evidence for its conclusion, because the parties by their pleadings had admitted the waters in question were not percolating by both relying on alleged prior appropriations. Since the trial court made no finding as to priority, the case was ordered remanded. As to the well water, the Court reversed the lower court's finding that the well was located on defendants' property as the only direct evidence indicated the contrary.

The Court rejected plaintiff's claim to water from a fourth spring based on adverse possession. The evidence indicated that the spring was located on land to which defendant had a grazing allotment, and that defendants' cattle had been running in the vicinity. The Court felt that if these facts were established in the trial court it would defeat any claim to adverse possession since the plaintiff's possession would not have been exclusive.

[1] 84 Ariz. 207, 326 P.2d 33 (1958). See also COURTS AND PROCEDURE, *supra*.

Wills and Administration

GARY KELTNER

The 1958 decisions of the Arizona Supreme Court on the subject of Wills and Administration might be clasified into four main categories: 1) Duties of an Executor Regarding the Termination of Probate; 2) Effect of a Termination of Probate; 3) Presentment of Claims Against the Estate; and 4) Construction of Wills. Each of these topics is discussed in order.

Duties of an Executor Regarding the Termination of Probate

That the duties of an executor are limited to the winding up of a decedent's estate and are of a temporary character was forcefully emphasized by *Pintek v. Superior Court.*[1] This was an action for mandamus to compel the termination of the probate of a decedent's estate. Upon the refusal of the superior court to issue the desired writ, mandamus was sought. The Supreme Court concluded that mandamus was, under A.R.S. § 12-2021,[2] the proper remedy, provided: 1) the respondents were under a duty to close and distribute the estate; and 2) the estate was in a position to be closed. In regard to the first of these essentials, it appeared from the facts that letters testamentary had been issued some six years prior to the institution of the present action, but that the estate had not been closed or distributed. It was offered in justification that the estate could not be closed until all minors who were beneficiaries under the will had reached their majority. In rejecting this contention the Court said:

> The duties of an executor *are limited to the winding up of the estate of a decedent and are temporary in their character.* In the absence of a statute otherwise providing, the duties of an executor are: 1) to reduce to possession the personal assets of the testator; 2) to pay the testator's debts; 3) to pay legacies; and 4) to distribute the surplus, if any, among the testator's next of kin.[3] (Emphasis added by the Court.)

[1] 84 Ariz. 279, 327 P.2d 292 (1958).

[2] "A writ of mandamus may be issued by the supreme or superior court to any person, inferior tribunal . . . to compel, when there is not a plain, adequate and speedy remedy at law, performance of an act which the law specially imposes as a duty resulting from an office, trust or station, or to compel the admission of a party to the use and enjoyment of a right or office to which he is entitled. . . ."

[3] RESTATEMENT, TRUSTS, § 6, Comment b (1935).

The Court justified its conclusion with the statement that "It is the policy of the law that administration be had with dispatch and that distribution be made as soon as possible. This policy is made manifest in the provisions of our code with the subject."[4] The Court fortified its decision in this regard by its finding that there existed a similar duty under the provisions of the will. Having thus determined the existence of a duty to close the estate and to distribute the surplus, the Court next proceeded to the question of whether or not the estate was in a position to be closed. In this respect, it was argued that such a determination lay in the discretion of the probate judge, but the Court countered by citing the fact that the probate judge had indicated that the estate should be closed (having based his refusal to grant mandamus on other grounds[5]) and further stated that to allow the probate to continue indefinitely without good cause would be an abuse of discretion. The Court therefore issued the desired writ, ordering the respondents to act with dispatch and diligence in terminating the probate of the estate.

Effect of a Termination of Probate

Fernandez v. Garza[6] vividly illustrated the point that the probate and distribution of an estate is not conclusive of the rights of strangers, i.e., third persons whose claims rest neither on heirship nor upon their rights as creditors. This case involved an attempt by one Garza to have a decree of final accounting and distribution set aside. The basis of Garza's claim was, first, that she was the owner of part of the property embodied in the decree, and second, that she was attempting to prove such ownership in litigation which was pending against the administratrix at the time of the decree of distribution and the discharge of the administratrix. It was her contention that such decree and discharge would operate to dissipate the pending suit.[7] The Court met the first of these contentions with the statement that as Garza was not claiming as either an heir or a creditor of the estate, "but as a stranger," her rights could not have been determined by the probate court, and

[4] A.R.S. Title 14, Chapter 5. See specifically, A.R.S. § 14-669.

[5] Judge Udall, presiding, apparently felt that as the petition called for a review of all prior preceedings involving the same estate, that the matter was more properly one for the cognizance of the Supreme Court. The other proceedings were: Pintek v. Superior Court, 78 Ariz. 179, 277 P.2d 265 (1954); Pintek v. Superior Court, 81 Ariz. 255, 304 P.2d 392 (1956) (In this connection, see 1956 Survey of Arizona Law 154); and Pintek v. Kesmer, which was pending at the time of this action.

[6] 83 Ariz. 318, 320 P.2d 948 (1958).

[7] Garza v. Fernandez, 74 Ariz. 312, 248 P.2d 869 (1952), in which the Supreme Court reversed a summary judgment in favor of Fernandez, the administratrix, and remanded for trial.

that to the extent that the decree of such court involved property owned by one other than the deceased, it was a nullity for lack of jurisdiction.[8] In rejecting the second argument, the Court held that the decree of final distribution and the discharge of the administratrix could not operate to dissolve the pending suit. Accordingly, the Court concluded that the legal position of the appellee could in no way be enhanced by the overthrow of the probate decree, while, on the other hand, a refusal to overturn such decree would in no way prejudice her legal position. Such being the case, the appellee had stated no ground for relief and the decision of the trial court was reversed, the probate decree being reinstated.

Presentment of Claims Against the Estate

Brainard v. Walters[9] was a case of first impression in which the Court was squarely presented with the question of whether or not an unliquidated claim in tort[10] can be prosecuted after the expiration of the period allowed for presentation of claims to administrators without having been presented during that period. The Court's conclusion that the claim was not barred rested on its construction of the following three statutes:

> A.R.S. § 14-570: A. All claims *arising upon contracts*, whether due, not due or contingent, shall be presented to the executor or administrator within the time limited in the notice to creditors, and any claim not so presented is barred forever . . . . (Emphasis added.)
>
> A.R.S. § 14-577: The holder of a claim against an estate shall not maintain an action thereon unless the claim is first presented to the executor or administrator . . . .
>
> A.R.S. § 14-576: If an action is pending against the decedent at the time of his death, plaintiff shall in like manner present his claim to the executor or administrator for allowance or rejection as required in other cases. No recovery shall be had in the action unless proof is made of the presentation.

The Court, in holding that the word "claim," as used in the statutes, was not applicable to unliquidated claims arising in tort, relied heavily

[8] Horne v. Blakely, 35 Ariz. 39, 274 P. 173 (1929).
[9] 85 Ariz. 60, 331 P.2d 595 (1958).
[10] The action was for damage to an automobile which resulted from a collision allegedly caused by the negligent driving of the deceased.

upon three outside decisions.[11] The Court concluded saying, "the statute only applies to claims arising upon contract." Does this, then, mean that the result would have been different had the claim been an unliquidated claim arising through a contract?

Construction of a Will

In re Shields' Estate[12] the question presented was whether or not parol evidence was admissible to show what the term "notes and mortgages," as used in a will, was intended to encompass. It was contended that as the deceased owned no notes or mortgages at the time of the will's execution, nor thereafter until the time of his death, there was a latent ambiguity. The ambiguity would justify the admission of parol evidence to show that the intended bequest included certain contracts for the sale of realty owned by the deceased and which were carried on his books, in his writing, as "mortgages." It was insisted in reply that, first, there was no latent ambiguity present and, second, granting there be such an ambiguity and that parol evidence is admissible, it would not be admissible to establish that which the deceased intended to say, but did not. The Court met the first of these objections, that there was no latent ambiguity present, with the conclusion that the will, although clear and intelligible on its face, became insensible in the light of the extrinsic fact that the deceased did not own or possess any notes and mortgages. This, the Court stated, constituted a latent ambiguity such as to justify the admission of parol. The Court then disposed of the second argument with the statement that, although ". . . parol evidence will not be permitted to show what the testator intended to say," such evidence is admissible ". . . to show what the testator intended by what he said." With the drawing of this distinction, the Court concluded that it was reasonable to believe that the deceased intended, by use of the words "notes and mortgages," to include his contracts for the sale of real property.

The Arizona Court, then, apparently follows the general rule that parol evidence is admissible, upon the discovery of a latent ambiguity, for the purpose of discovering the meaning of the words used.[13]

[11] These decisions were: Hornbeck v. Richards, 80 Mont. 27, 257 P. 1025 (1927); Becker v. State, 312 P.2d 935 (Okla. 1957); and National Automobile and Casualty Insurance Co. v. Ainge, 34 Cal. 2d 806, 215 P.2d 13 (1950), in which the court stated, "Ever since what is now section 707 was amended to include the phase [sic] 'arising upon contract,' it has been regarded as defining what claims are meant by the other sections."

[12] 84 Ariz. 330, 327 P.2d 1009 (1958).

[13] 94 A.L.R. 47 at 48 (1935).

Workmen's Compensation

John Lewis

Judicial Estoppel

Lord Kenyon once said that a man shall not be permitted to "blow hot and cold." This was an expression of the Latin maxim *allegans contraria non est audiendus*—he is not to be heard who alleges things contradictory to each other. *Worthington v. Industrial Commission*[1] seems to be a unique application of this maxim.

Worthington was killed in an automobile accident. The driver of the car, Lipscomb, was also killed. The two men were returning from a mine near Yuma owned by the Little Horn Mining Company, a partnership, which was insured under Workmen's Compensation. Lipscomb was a partner in the firm. Worthington's widow, in the capacity of executrix of his estate, sued Lipscomb's estate for wrongful death. Lipscomb's estate defended on the ground that Worthington, at the time of his death, was an employee of the Little Horn Mining Company and Lipscomb, as a partner in the firm, was Worthington's employer; and therefore under A.R.S. § 23-1022, the widow's exclusive remedy was against the Industrial Commission. The case never went to trial and was settled for $7,000. The widow then claimed death benefits under the Workmen's Compensation Act.

The commission denied compensation on the ground that Worthington was not an employee at the time of his death. The Supreme Court affirmed the decision of the commission denying compensation, saying that when the widow, as executrix, brought the action for wrongful death she made ". . . an assertion and representation that decedent was not an employee at the time of the accident . . . . She cannot now be allowed to say she made the recovery of $7,000 on a false basis."

Though the Court did not attach a label to the theory of its decision in the instant case, it appears to have been an application of the doctrine of *judicial* estoppel. In this type of estoppel the usual element of prejudicial reliance by the opposite party is, to a greater or lesser extent, absent.[2]

> The general rule as to estoppel to assume inconsistent positions in judicial proceedings . . . has been expressly stated to apply, or

[1] 85 Ariz. 104, 333 P.2d 277 (1958).
[2] 31 C.J.S. *Estoppel* § 117 (1942).

> has been applied so as to estop a party to assume inconsistent positions in successive proceedings. For this doctrine to be applied, it is commonly required that parties be the same, and that the same questions be involved. However, some authorities have held that the parties need not be the same where the position assumed in the former proceeding was successfully maintained . . . judicial estoppel arising from pleadings or testimony in former proceedings may operate for the benefit of persons who were not parties to the former proceeding.[3]

The foundation of the doctrine of judicial estoppel has been pointed out by the Arizona Supreme Court previously in *Martin v. Wood.*[4]

> This doctrine is said to have its foundation in the obligation under which every man is placed to speak and act according to the truth of the case, and the policy of the law to suppress the mischiefs from the destruction of all confidence in the intercourse and dealings of men, if they were allowed to deny that which by their solemn and deliberate acts they have declared to be true.

It seems that the doctrine is sound, but there may arise situations where its application would seem to be unduly harsh if carried to its dryly logical extreme. For example, suppose a person is injured to the extent of $10,000 and, under a mistake of law, brings an action against A. As the proceedings develop the plaintiff becomes more and more doubtful about A's legal responsibility. This doubt results in a very small settlement, say, $100. Then the plaintiff proceeds against B who is legally responsible, as the plaintiff has belatedly discovered. In such a situation it would seem that the value of the doctrine in putting an end to litigation might be misplaced unless it was weighed against the apparent harshness and injustice of its application under the circumstances.

When the injured party chooses the wrong defendant it would seldom seem to be based on wilful misrepresentation or unconscionable conduct. Moreover, it would be a rare defendant who would place much reliance upon the plaintiff's representation of a legal conclusion.

In the *Worthington* case the Court concluded that Mrs. Worthington was inconsistent. By bringing the action for wrongful death in the capacity of executrix, she impliedly asserted that her husband was not an employee, for if he had been, her exclusive remedy would have been

[3] 31 C.J.S. *Estoppel* § 119 (1942).
[4] 71 Ariz. 457, 229 P.2d 710 (1951).

against the Industrial Commission. In subsequently seeking compensation from the commission she alleged that her husband had been an employee. The Court's conscience was repelled by the thought of allowing her to say that her recovery in the wrongful death action had been on a "false basis." Since she recovered under the former assertion she could not be allowed to recover on another which impliedly repudiated it.

If the Court was correct in concluding that the inconsistency was sufficiently unconscionable to bring the doctrine of judicial estoppel into play, the case is at least somewhat unique, for in bringing the prior wrongful death action the plaintiff was acting in her capacity as executrix of the estate, whereas in the proceedings before the commission she was acting in another capacity, that of an alleged beneficiary under the Workmen's Compensation Act. Should her acts in one capacity forfeit her rights in another? The authorities on the question presented by this case are not numerous, but some have allowed recovery and found no estoppel.[5]

However, at the present time, the law in Arizona seems to warn litigants not to conduct themselves inconsistently with the matter at hand, no matter what their legal capacities may be at the time.[6]

Hearsay Evidence

It is the law of administrative agencies generally, both federal and state, that hearsay evidence may properly be admitted and may usually be given probative effect if it is of the type upon which responsible persons are accustomed to rely in serious affairs.[7] The problems arise, not on the question of admissibility of such evidence, but on the probative value which may be attached to it.[8] The vast majority of case law on the subject has arisen because of the agency's *reliance* on hearsay in making its findings.[9] Few cases can be found where the reviewing court has actually reversed an agency's finding because of *failure* to rely on hearsay.[10] *Hudgens v. Industrial Commission*[11] appears to fall within this unique class.

In the *Hudgens* case the petitioner sought compensation for a heart injury allegedly caused by the lifting of doors in the course of his job as a carpenter. He worked alone and was unable to testify about his

[5] E.g., Newark Paving Co. v. Klotz, 91 Atl. 91 (1914).
[6] Since this article went to press, the Worthington case was reversed on rehearing. 85 Ariz. 310, 338 P.2d 363 (1959).
[7] DAVIS, ADMINISTRATIVE LAW, 455 *et. seq.* (1951).
[8] 2 LARSON, WORKMEN'S COMPENSATION LAW § 79.00 (1952) 278.
[9] DAVIS, *op. cit. supra*, note 1, at 458.
[10] One of these is NLRB v. Ohio Calcium Co. 133 F.2d 721 (6th Cir. 1943).
[11] 83 Ariz. 383, 321 P.2d 1039 (1958). Also noted in EVIDENCE, *supra*.

activities on the day the alleged injury occurred because of his health. His superintendent testified that some time within three or four days preceding the attack petitioner had hung four doors (but no one actually saw him do so). The physician who attended petitioner shortly after his heart attack testified that in the course of his diagnosis the petitioner said the pain commenced ". . . after I had lifted some heavy door jambs." The physician also testified in response to a hypothetical question, that lifting of 75 lb. *doors* "could be considered adequate physical exertion to be a precipitating factor."

The Supreme Court, recognizing that the burden of proving that the exertion of the job precipitated the heart attack was on the petitioner, and that this fact must be the "only possible inference drawable from the evidence" in order for the award to be set aside, held that the only permissible inference from the evidence was that the injury was caused by the hanging of heavy doors. Thus, the Industrial Commission was reversed on the ground that the evidence of causal connection, although hearsay, was so strong that it permitted no inference to the contrary. In support of their decision the court merely stated:

> [To sustain this burden of proof] . . . [h]e may rely upon circumstantial evidence, Martin v. Industrial Commission, 73 Ariz. 401, 242 P.2d 286, and the Commission may properly admit hearsay evidence, Kelsey v. Industrial Commission, 79 Ariz. 191, 286 P.2d 195.

There is a multiplicity of views on the extent to which an administrative agency *may* rely on hearsay, although the authorities are almost non-existent on the extent to which they *must* so rely.

The orthodox "legal residuum rule" is followed, usually in modified forms, in the majority of jurisdictions, although it has been under constant attack ever since it was announced.[12] The case which originated the rule was *Carroll v. Knickerbocker Ice Co.*[13] That case involved the construction of a statute purporting to abrogate the technical rules of evidence in compensation proceedings similar to A.R.S. § 23-942.[14] The New York court construed the provision to apply only to the technical rules of admission and exclusion and held it had no application to the

[12] WIGMORE, EVIDENCE 40-41 (3rd ed. 1940); HOROVITZ, WORKMEN'S COMPENSATION 240-241.

[13] 113 N.E. 507 (N.Y. 1916).

[14] A.R.S. § 23-942 provides:

> The commission shall not be bound by the rules of evidence or by the technical or formal rules of procedure other than as provided in this chapter. The commission may conduct investigations in such manner as in its judgment is best calculated to ascertain the substantial rights of the parties and to carry out the spirt of this chapter.

quality of evidence needed to sustain a finding on review. For the latter purpose, the court insisted upon a "residuum" of evidence which would be competent by common-law statements. This rule, if strictly followed, would, in effect, bind the agency to common-law rules of evidence insofar as the court of review is concerned in determining the evidence sufficient to sustain the agency's findings.

The rigors of the "legal residuum rule" have been modified by most courts, including New York.[15] The most liberal view is that followed in California and a few states[16] which allows an award to be sustained entirely on hearsay evidence in a proper case. The ***Hudgens*** case is a manifest indication that Arizona does not follow the "legal residuum rule." Since the commission was there reversed on the basis of hearsay it would seem to be a permissible conclusion that Arizona will follow the more liberal trend in reviewing the commission's findings when based upon hearsay evidence.

Earning Capacity

Petitioner was a heavy laborer with only a fourth grade education. He was injured severely in the course of employment. He had worked in heavy labor most of his life. His employer made a job for him, which did not require heavy labor, to keep him on. This job was merely on a "temporary basis because his physical condition was such that he was not otherwise qualified to retain a responsible position in industry" and because he had been in their employ at the time of the injury. The commission determined the loss of earning capacity by comparing his wages after the injury with those before the injury. This award was set aside by the Supreme Court in *Wammack v. Industrial Commission.*[17] The Court decided the earnings from subsequent temporary jobs are not the measure,

> . . . The Commission is to determine as nearly as possible whether in a competitive labor market the subject in his injured condition, can probably sell his services and for how much . . . . There must be some evidence that the man is able to adequately perform the services in the classification prescribed. Davis v. Industrial Commission, 82 Ariz. 173, 309 P.2d 793.

[15] See, e.g., Altschuller v. Bressler, 46 N.E.2d 886 (N.Y. 1943).
[16] State Compensation Insurance Fund v. Ind. Acc. Comm., 231 P. 996 (Calif. 1924); Humphries v. Boxley Bros. Co., 135 S.E. 890, 49 A.L.R. 1427 (Va. 1926).
[17] 83 Ariz. 321, 320 P.2d 950 (1958).

This seems to follow the general rule that ". . . the labor market in which claimant establishes his earning capacity should not be an abnormal one."[18]

Gallo v. Industrial Commission[19] is an illustration of the "boom and bust" doctrine. The case also discusses the effect of A.R.S. § 23-1044 as to requirements for modifying an award. At the time of the injury in the course of employment, the petitioner was earning $208 per month. The award was given when § 56-957 A.C.A. 1939[20] was in effect. Seven years later, when A.R.S. § 23-1044 was in effect, the award was ordered terminated because the petitioner was earning $280, and therefore his earning capacity was not impaired. The Court said that since the award was given under the 1939 code, § 56-957 A.C.A. 1939, *supra,* still governed because the change caused by A.R.S. § 23-1044(F)[21] affects vested rights and is therefore not retroactive.[22] The requirements under § 56-957, A.C.A., *supra,* to change a final award were the showing of an increase in earning capacity subsequent to the award resulting from a change in physical condition. These two requirements were shown in this case, but the Supreme Court still set aside the award of the commission terminating the benefits, being of the opinion that the "boom and bust" doctrine of *Whyte v. Industrial Commission*[23] governed. The Court said: "In determining increased earning capacity the commission must exclude any increase or decrease in wages due solely to business booms or depres-

[18] 2 LARSON, WORKMEN'S COMPENSATION LAW § 57.35 (1952) 17.

[19] 83 Ariz. 392, 322 P.2d 372 (1958).

[20] Section 56-957 (c) and (d) A.C.A. 1939 provide:

(c) In cases not enumerated in subsection (b), where the injury causes partial disability for work the employee shall receive, during such disability, compensation equal to fifty-five (55) per cent of the difference between his average monthly wages before the accident and the monthly wages he is able to earn thereafter, but the payment shall not continue after the disability ends, or the death of the injured person, and in case the partial disability begins after a period of total disability, the period of total disability shall be deducted from such total period of compensation.

(d) In determining the percentage of disability, consideration shall be given, among other things, to any previous disability, the occupation of the injured employee, the nature of the physical injury, and the age of the employee at the time of the injury. In case there is a previous disability, the loss of one eye, one hand, one foot, or otherwise, the percentage of disability for a subsequent injury shall be determined by computing the percentage of the entire disability and deducting therefrom the percentage of the previous disability as it existed at the time of the subsequent injury.

[21] A.R.S. § 23-1044(F) provides:

For the purposes of subsection C of this section, the commission shall, not later than nine months from the time the physical condition of the injured employee becomes stationary, determine the amount which represents the reduced monthly earning capacity, and upon such determination make an award of compensation which shall be subject to change only in the event of a subsequent change in the physical condition of the injured employee resulting from the injury and affecting his earning capacity.

[22] A.R.S. § 1-244: "No statute is retroactive unless expressly declared therein."

[23] 71 Ariz. 338, 227 P.2d 230 (1951).

sions." The Court was of the opinion that the increase in the petitioner's wages was the result of a general business boom.

The Court, in a general discussion of the difference between § 56-957 A.C.A. (c) and (d), *supra,* and A.R.S. § 23-1044(F), *supra,* said that the latter substantially changes the same section in the 1939 code and allows the commission to modify an award only upon the showing of a subsequent change in the physical condition of the injured party.

Res Judicata

The res judicata aspect of the commission's findings was discussed in *Dickey v. Industrial Commission.*[24] Dickey was denied compensation on rehearing of the commission on April 11, 1951. The language of the denial was unequivocal. However, in this decision the commission further ordered that if Dickey became totally disabled by silicosis, the commission would consider his claim. No appeal was taken from this order, and over 5 years later Dickey filed a petition based on new evidence relying on his right to reopen the original application. The "further order" of the commission, the Court held, was merely an attempt to apply A.R.S. § 23-1268(B)[25] which failed because the statute applies only where "compensation previously granted has been terminated," and in this case, compensation had never been granted. Therefore the order was final and, as it was not appealed within the statutory time provided, the Supreme Court said that it became res judicata.

Judicial Review

The petitioner in *Wammack v. Industrial Commission of Arizona, supra,* applied for a second rehearing to the commission, but prior to any formal action by the commission, a petition for writ of certiorari was filed in the Supreme Court. The Court had held that "While a party has the privilege of applying for a second rehearing, he is not compelled to do so in order to exhaust his administrative remedies. . . ."

[24] 83 Ariz. 283, 320 P.2d 470 (1958).
[25] A.R.S. § 23-1268 (B) provides:
Where the disablement has terminated and within one year thereafter, or in case of silicosis or asbestosis within two years thereafter, the disablement recurs as a result of the occupational disease for which an award has been made, the commission may order resumption of compensation if claim therefor is made within sixty days after recurrence of the disablement.

Miscellaneous

In *Warner v. Industrial Commission*[26] the Superior Court held that the claimant, seeking to have his case reopened and compensation increased, did not bear the burden of showing that his physical condition had worsened due to the accident, and affirmed the commission's finding as it was reasonably supported by the evidence.

Aircraft Instrument Corp. v. Craft[27] involved conflicting evidence as to whether the party seeking compensation was an employee or an independent contractor. The commission found the party to be an employee. In affirming this finding the Court stated the conclusion of the commission must be given the same "considerations" as those of a "jury or trial court."

The petitioner claimed disability by reason of "kissing spines" resulting from a back injury during employment, and doctors differed in their testimony as to the causal connection between "kissing spines" and the claimed disability in *Lopez v. American Smelting & Refining Co. and the Industrial Commission.*[28] The Court concluded that where a case calls for expert testimony and there is a conflict in medical testimony, the commission is free to decide which expert it chooses to believe.

In *Harrington v. Industrial Commission,*[29] decedent went to Phoenix on business. There he picked up a customer and was driving toward Tucson, his home, with the customer. Due to a disagreement the customer left the car at Chandler and deceased was seen proceeding in the direction of Tucson. He was next seen speeding back toward Coolidge, away from Tucson, in the general direction of Chandler and Phoenix, when the fatal accident occurred. The conduct of the deceased prior to the accident permitted more than one inference, the Court said, and the finding of the commission that the deceased was not within the scope of employment was one of these. The Court said in cases where the evidence is uncontradicted but permits more than one inference, the finding of the commission is conclusive upon review.

The petitioner in *Sheridan v. Industrial Commission*[30] alleged that he suffered a back injury in the course of employment. His testimony as to the date of the injury was corroborated by the testimony of a fellow workman. The medical testimony showed a causal connection between the injury and the alleged accident. The Supreme Court decided the commission was wrong in denying compensation as there was no evidence to support such a finding.

[26] 85 Ariz. 150, 333 P.2d 733 (1958).
[27] 85 Ariz. 14, 330 P.2d 729 (1958).
[28] 84 Ariz. 7, 322 P.2d 890 (1958).
[29] 84 Ariz. 356, 328 P.2d 311 (1958).
[30] 84 Ariz. 264, 327 P.2d 90 (1958).

NOTES

ADMINISTRATIVE LAW—ARIZONA ADMINISTRATIVE PROCEDURE ACT—AGENCY REGULATIONS ADOPTED AND FILED MUST BE CERTIFIED TO BECOME EFFECTIVE.—The defendant was charged with violation of a regulation adopted by the Arizona Commission of Agriculture and Horticulture. Although the rule in question was filed in the office of the secretary of state and signed by the state entomologist, it was not certified as required by the Arizona Administrative Procedure Act.[1] On certification, *held,* strict compliance with statute required. Administrative rules and regulations filed with the secretary of state are of no force or effect unless they bear a certification signed by some officer in authority. *State v. Wacker,* 344 P.2d 1004 (Ariz. 1959).

For over a century, federal statutes conferring rule-making authority upon administrative agencies lacked definitive procedure governing preparation of regulations. Persons affected by the rules often remained unaware of their content; and legal advisers found it difficult, if not impossible, to secure knowledge of the subordinate legislation for guidance of their clients' conduct.[2] The embarrassing consequences of the famed *Hot Oil* case,[3] coupled with growing dissatisfaction with inadequate methods of publication, probably led to enactment of the Federal Register Act.[4] This statute and the later Federal Administrative Procedure Act[5] alleviated the main problems with regard to publication and notice of federal rules by requiring publication of regulations formulated and adopted by agencies for guidance of the public.[6] Indicative of current federal law, the Ninth Circuit has firmly held: "Unless the prescribed procedures are complied with, the agency (or administrative) rule has not been legally issued and consequently it is ineffective."[7]

[1] A.R.S. §§ 41-1004, -1005 (1956). Section 41-1004(A) provides: "Every rule adopted by each agency shall be certified and filed with the office of the secretary of state or shall be of no force or effect. . . ." Sections 41-1005 states: "No rule adopted or promulgated by an agency shall become effective until a certified copy thereof has been filed in the office of the secretary of state. . . ."

[2] GELLHORN & BYSE, CASES ON ADMINISTRATIVE LAW 90 (1954).

[3] Panama Refining Co. v. Ryan, 293 U.S. 388, 412 (1935). During oral argument counsel for the government was abashed by questions from the bench regarding publication of the "code" used by the NRA and was forced to admit no official publication. CORWIN, THE PRESIDENT 367 (1940).

[4] 49 Stat. 500 (1935), as amended, 44 U.S.C. §§ 301 to 314 (1952).

[5] Section 3(a), 60 Stat. 237 (1946), 5 U.S.C. § 1001 (1952).

[6] Newman, *Government and Ignorance—A Progress Report of Federal Regulations,* 63 HARV. L. REV. 929, 942 (1950).

[7] Hotch v. United States, 212 F.2d 280, 283 (9th Cir. 1954).

The federal archetype has been followed in many states. According to a 1953 study, there were twenty-four states which required filing of rules in a central office, usually with the secretary of state, and four which directed the agencies themselves to publish their regulations. Also fourteen states provided for codification and publication of the filed administrative rules.[8] The MODEL STATE ADMINISTRATIVE PROCEDURE ACT[9] has served as a guide for state legislation. Sections 3 and 4 furnish the procedure for filing certified copies of administrative rules in some centralized depository. Arizona's Administrative Procedure Act, which is patterned after the model act, requires filing of certified copies with the secretary of state.[10]

Regulations of sixty-one agencies were, prior to the instant case, on file with the secretary of state, but many unfiled amendments to such regulations were being enforced without protest. Although some superior courts have dismissed for non-compliance with filing requirements cases involving violation of agency rules, litigation in this area remains slight as the public generally has assumed without question the validity of the rules. This decision has induced several agencies, including the Arizona Commission of Agriculture and Horticulture, to file certified copies of their amendments and supplements with the proper authority.[11]

The decision of this case turns on a question of statutory construction. The primary rule of construction is to ascertain and declare the intention of the legislature,[12] and carry such intention into effect.[13] The purpose for which a statute is enacted is of primary importance in the interpretation thereof and is a proper subject of consideration.[14] The ultimate purpose of the act in question is to insure public notice of rules

[8] Davis, *Administrative Practice and Procedure: Comparative State Legislation*, 6 OKLA. L. REV. 29, 34-38 (1953). See also HEADY, ADMINISTRATIVE PROCEDURE LEGISLATION IN THE STATES 33-40 (1952); *cf.* Akers, *Your Administrative Regulation Program*, 17 KY. S.B.J. 141 (1953); Byse, *Administrative Procedure Reform in Pennsylvania*, 97 U. PA. L. REV. 22, 35-37 (1948); Nathanson, *Recent State Administrative Procedure Legislation*, 33 IOWA L. REV. 252, 256-259 (1948); Silk, *The Publication of Regulations and Other Delegated Legislation*, 20 CAN. B. REV. 604 (1942); and compare *Note, Judicial Notice of Administrative Regulations*, 60 HARV. L. REV. 1137 (1946).

[9] HANDBOOK OF NATIONAL CONFERENCE OF COMMISIONERS ON UNIFORM STATE LAWS 83-6 (1943).

[10] A.R.S. §§ 41-1001 to 41-1008 (1956).

[11] Interview With Secretary of State Wesley Bolin, Nov. 6, 1959.

[12] See, *e.g.*, State *ex rel.* Sullivan v. Burns, 51 Ariz. 384, 77 P.2d 215 (1938); see also Arizona Eastern R.R. v. Matthews, 20 Ariz. 282, 180 Pac. 159 (1919), overruled on another point in Consol. Arizona Smelting Co. v. Egich, 22 Ariz. 543, 199 Pac. 132 (1920).

[13] See, *e.g.*, Hill v. Gila County, 56 Ariz. 317, 107 P.2d 377 (1940); see also Automatic Registering Mach. Co. v. Pima County, 36 Ariz. 367, 285 Pac. 1034 (1930).

[14] See, *e..g.*, Carr v. Frohmiller, 47 Ariz. 430, 56 P.2d 644 (1936); see also Street v. Commercial Credit Co., 35 Ariz. 479, 281 Pac. 46 (1929).

[15] Interview With Secretary of State Wesley Bolin, Nov. 6, 1959.

adopted by administrative agencies.[15] The statutory requirements of filing and publication of such regulations give notice of their existence to the public, satisfying this purpose.[16] Failure to file has been held to invalidate a regulation, and such a result is probably in accord with legislative intent.[17]

Where actual notice of the regulation's existence is clear, it has been held that even lack of filing does not invalidate the administrative rule. For example, *People v. Calabro*,[18] stated that the primary purpose of a constitutional provision denying effect to unfiled regulations and requiring speedy publication of such rules was to assure public knowledge. Also a 1958 New Mexico case[19] based on a similar statute held that all unfiled regulations are not ineffective, but such unfiled rules merely are invalid as against persons who have no actual knowledge of their content. Since this is so, non-compliance with the subsidiary requirement of certification, *a fortiori,* should not be allowed to defeat the accomplished purpose. Here the rule in question was adopted by the commission, filed with the secretary of state, accepted and published as though it were properly certified. Effect was denied solely because of a technical error, one which leaves little doubt that the purpose of the statute was substantially carried out.

Indeed, it is a wholesome and necessary principle that an administrative agency must pursue the procedure and rules enjoined upon it by statute, and show a *substantial* compliance therewith, to give validity to its action.[20] The rule of strict construction, however, should not be carried beyond the reason for its existence. Nevertheless, the interpretation rendered will awaken state administrative agencies from their incautious slumber to a sharpened awareness of procedural requirements animated by this decision.

Bernard C. Porter

CONSTITUTIONAL LAW—FAIR TRADE ACT—NON-SIGNER PROVISION CONSTITUTIONAL.—The plaintiff, General Electric Co., had contracts with retailers setting minimum retail prices at which "GE" products could be resold. It sought an injunction under the Arizona Fair

[16] *Ibid.*

[17] Magis v. Lyman-Richey Sand and Gravel Corp., 189 F.2d 130 (8th Cir), *cert. denied* 342 U.S. 877 (1951); Mondovi Co-op. Equity Ass'n v. State, 258 Wis. 505, 46 N.W.2d 825 (1951).

[18] 170 N.Y.S.2d 876 (1957); N. Y. CONST. art. IV, § 8.

[19] Maestas v. Christmas, 63 N.M. 447, 321 P.2d 631 (1958).

[20] Panama Refining Co. v. Ryan, *supra* note 3; Wichita R.R. & Light Co. v. Pub. Util. Comm'n, 260 U.S. 48 (1922).

Trade Act[1] to enjoin the defendant, a "non-signer" retailer, from future sales of its products below the fixed price. The defendant challenged the constitutionality of the statute, and prevailed in the superior court. On appeal, *held,* reversed. The Arizona Fair Trade Act does not unconstitutionally create a monopoly, nor deny due process or equal protection of the law as it affects non-signers of minimum price agreements made thereunder. *General Electric Co. v. Telco Supply, Inc.*, 84 Ariz. 132, 325 P.2d 394 (1958).

The Arizona statute is typical of the numerous[2] fair trade acts in that it permits a producer or distributor of trade marked or brand goods in fair (free) and open competition with commodities of the same general class to stipulate in a contract with one buyer a resale price which is binding upon all who have notice of the price so set.[3] The statute gives a cause of action to anyone damaged as a result of a willful sale at less than the stipulated price.[4]

Under the Sherman Anti-trust Act of 1890,[5] price fixing was illegal *per se.*[6] The Miller-Tydings Act of 1937[7] legalized vertical fair trade price agreements between the contracting parties,[8] but this was held by the United States Supreme Court not to authorize the non-signer clause.[9] Congress soon thereafter enacted the McGuire Act which specifically exempted the non-signer clause from federal anti-trust laws.[10]

The California Fair Trade Act as amended in 1933 to include the non-signer clause,[11] became the prototype of most state fair trade statutes. In the case of *Old Dearborn Distributing Co. v. Seagram-Distillers Corp.*[12] the United States Supreme Court, in interpreting a similar Illinois statute, held that the good will symbolized in the trade-mark remains the property of the producer, and a proper subject of legislative protection. It then concluded that the fair trade law was not so arbitrary and unfair as to constitute a denial of due process or equal protection. This remains the interpretation in the federal courts,

[1] A.R.S. §§ 44-1421 to 44-1426 (1956).

[2] Only the states of Alaska, Missouri, and Texas have not enacted the fair trade act. Vermont has not enacted the non-signer clause into its fair trade act. 11 ARK. L. REV. 105 (1957).

[3] A.R.S. §§ 44-1422, -1423 (1956).

[4] A.R.S. § 44-1423 (1956).

[5] 26 Stat. 209 (1890), as amended, 15 U.S.C. §§ 1-7 (1952).

[6] Kiefer-Stewart Co. v. Seagram & Sons, 340 U.S. 211 (1951), United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940).

[7] 50 Stat. 693 (1937), 15 U.S.C. § 1 (1952).

[8] *Ibid.*

[9] Schwegmann Bros. v. Calvert Distillers Corp., 341 U.S. 384 (1951).

[10] 66 Stat. 632 (1952), 15 U.S.C. § 45 (a) (1-4) (Supp. 1958).

[11] CAL. BUS. & PRO. CODE §§ 16900-16906.

[12] 299 U.S. 183 (1936).

as evidenced by the 1953 decision of the Fifth Circuit Court of Appeals,[13] despite a strong recommendation for reappraisal voiced in the dissent,[14] and by the district judge.[15]

Of the 32 states that have passed upon the constitutionality of the non-signer clause, 16[16] have sustained it as valid and 16[17] have found some constitutional fault with it. Of the 20 states that have passed on the question since 1952, 5 have held the acts valid,[18] while 15 have struck them down.[19] The most frequent criticisms of the non-signer clause which have prevailed are: denial of due process (12);[20] exceeding the police power (10);[21] and unlawful delegation of legislative authority

[13] Schwegmann Bros. Giant Super Markets v. Eli Lilly & Co., 205 F.2d 788 (5th Cir.), *cert. denied* 346 U.S. 856 (1953).

[14] *Id.* at 793.

[15] Schwegmann Bros. Giant Super Markets v. Eli Lilly & Co., 109 F. Supp. 269 E.D. La. (1953).

[16] General Electric Co., v. Telco Supply, Inc., 84 Ariz. 132, 325 P.2d 394 (1958); Max Factor & Co. v. Kunsman, 5 Cal.2d 446, 55 P.2d 177 (1936); Burroughs Wellcome & Co. v. Johnson Wholesale Perfume Co., 128 Conn. 596, 24 A.2d 206 (1942); Klien v. National Pressure Cooker Co., 31 Del. Ch. 459, 64 A.2d 529 (1949); Seagram-Distillers Corp. v. Old Dearborn Distribution Co., 336 Ill. 610, 2 N.E.2d 940 (1936); Goldsmith v. Mead Johnson & Co., 176 Md. 682, 7 A.2d 176 (1939); General Electric Co. v. Kimball Jewelers Inc., 333 Mass. 665, 132 N.E.2d 652 (1956); W.A. Sheaffer Pen Co. v. Barrett, 209 Miss. 1, 45 So.2d 838 (1950); Lionel Corp. v. Grayson-Robinson Stores, Inc., 27 N.J. 54, 98 A.2d 623 (1954); Bourgois Sales Corp. v. Dorfman, 273 N.Y. 167, 7 N.E.2d 30 (1937); Eli Lilly & Co. v. Saunders, 216 N.C. 163, 4 S.E.2d 528 (1939); Burche Co. v. General Electric Co., 382 Pa. 370, 115 A.2d 361 (1955); Miles Laboratories v. Owl Drug Co., 67 S.D. 523, 295 N.W. 292 (1940); Frankfort Distillers Corp. v. Liberto, 190 Tenn. 478, 230 S.W.2d 971 (1950); Sears v. Western Thrift Stores of Olympia, 10 Wash. 2d 372, 116 P.2d 756 (1941); Bulova Watch Co. v. Anderson, 270 Wis. 21, 70 N.W.2d 243 (1955).

[17] Union Carbide & Carbon Corp. v. White River Distributors, Inc., 224 Ark. 558, 275 S.W.2d 455 (1955); Olin Mathieson Chemical Corp. v. Francis, 134 Colo. 160, 301 P.2d 139 (1956); Liquor Store, Inc. v. Continental Distilling Corp., 40 So. 2d 371 (Fla. 1949); Cox v. General Electric Co., 211 Ga. 268, 85 S.E.2d 514 (1955); Bissell Carpet Sweeper Co. v. Shane Co., 237 Ind. 188, 143 N.W.2d 415 (1957); Quality Oil Co. v. E. I. du Pont de Nemours & Co., 182 Kan. 488, 322 P.2d 731 (1958); General Electric Co. v. American Buyers Cooperative, Inc., 316 S.W.2d 354 (Ky. 1958); Dr. G. H. Tichenor Antiseptic Co. v. Schwegmann Bros. Giant Super Markets, 231 La. 51, 90 So. 2d 343 (1956); Shakespeare Co. v. Lippman's Tool Shop Sporting Goods, 334 Mich. 109, 54 N.W.2d 268 (1952); McGraw Electric Co. v. Lewis & Smith Drug Co., 159 Neb. 703, 68 N.W.2d 608 (1955); Skaggs Drug Center v. General Electric Co., 63 N.M. 215, 315 P.2d (1957);Union Carbide & Carbon Co. v. Bargain Fair, Inc., 167 Ohio St. 182, 147 N.E.2d (1958); General Electric Co. v. Whale, 207 Ore. 302, 296 P.2d 635 (1956); Rogers-Kent, Inc. v. General Electric Co., 231 S.C. 636, 99 S.E.2d 665 (1957); General Electric Co. v. Thrifty Sales, 5 Utah 2d 326, 301 P.2d 741 (1956); General Electric Co. v. Dandy Appliance Co., 103 S.E.2d 310 (W.Va. 1958).

[18] See note 16 *supra.*

[19] See note 17 *supra.*

[20] See Annot., 60 A.L.R.2d 420 (1958). See also General Electric Co. v. American Buyers Cooperative, Inc., *supra* note 17.

[21] Annot., 60 A.L.R.2d *supra* note 20.

[22] *Ibid.*

[23] *Ibid.*

(5).[22] Also, charges of denial of equal protection[23] and creation of monopolies have been upheld.[24]

In the instant case, in response to the contention that the fair trade act tended to create a monopoly in violation of the state constitution,[25] the Arizona Supreme Court pointed out that "an exclusive privilege or right is indispensable to the existence of a monopoly. . . ." and that the act expressly applies only to commodities in free and open competition. The court asserted that the guarantees in the Arizona Constitution of due process[26] and of equal protection[27] are the same as those in the 5th and 14th amendments of the U.S. Constitution, and followed the *Old Dearborn* case, *supra,* in its interpretation of these provisions. By such action the Arizona Supreme Court went against the current trend of state courts, and of writers who have, with almost universal accord, voiced the opinion that the present fair trade laws conflict with basic concepts of free competition, rights of property, and the exercise of the police power.[28] It is worthy to note that in 1945 the Federal Trade Commission recommended that the Miller-Tydings Act be repealed,[29] and that the Attorney General's National Committee to Study the Anti-Trust Laws has recommended the repeal of both the Miller-Tydings Act and the McGuire Act.[30]

The Arizona Supreme Court might well have given greater weight to the recent decisions of other jurisdictions which have acted to protect the property rights of the non-signer from restrictions which are clear and certain as opposed to the debatable and speculative dangers which threaten a producer's good will. The cogent argument that the legislature is without power to fix arbitrarily a minimum retail price, and therefore cannot delegate such a power to a select few, has not adequately been met. To permit a producer and a single retailer to so fix a price binding the whole retail industry is to permit these two to do that which would be illegal if accomplished by the concerted action of the entire retail industry.[31] Thus the signing retailer has bound the non-signer to the terms of a contract not of the latter's making, and which the two retailers would be prevented by law from entering into with each other.

[24] *Ibid.*
[25] ARIZ. CONST. art. 14 § 15.
[26] ARIZ. CONST. art. 2 § 4.
[27] ARIZ. CONST. art. 2 § 13.
[28] See Shulman, *The Fair Trade Acts and the Law of Restrictive Agreements Affecting Chattels,* 49 YALE L.J. 607 (1940). See also Rahl, *Resale Price Maintenance, State Action, and the Antitrust Laws: Effect of Schwegmann Brothers v. Calvert Distillers Corp.,* 46 ILL. L. REV. 349 (1951).
[29] FTC Rep. on Resale Price Maintenance LXI, LXIV (1945).
[30] Att'y Gen. Nat'l Comm. Antitrust Rep. (1951).
[31] See note 5 *supra.*

It is submitted that the arguments of the *Old Dearborn* case, born in the chaos of a depression and followed *sub silento* throughout the post war readjustment period, are not sufficient to withstand the current challenge that the real purpose of the fair trade laws may well be ". . . to protect the retailer from competition with another retailer, who, because of his efficient merchandising methods is able to reduce his distributive costs and consequently his retail price. . . ."[32]

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[32] Schwegmann Bros. Giant Super Markets v. Eli Lilly & Co., 109 F. Supp. *supra* at 272.

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